

Green bonds grow in California

By Natalie Jacewicz

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In this file photo, John Chiang, California State Controller, listens to fellow panelists during a discussion at the Silicon Valley Regional Economic Forum held at the Computer History Museum in Mountain View, Calif. on Friday, May 31, 2013. (Gary Reyes/ Bay Area News Group) (Gary Reyes)

California Treasurer John Chiang is embarking on a national tour this month aimed at seducing investors with an environmentally friendly investment alternative.

The state already has invested in these "green bonds," created to enable environmentally responsible projects, and issued them on a small scale.

Now Chiang wants to plant a full-fledged green bond market. Individuals and institutions, such as mutual funds and hedge funds, will have the opportunity to invest. The bonds promise to appeal to environmentally minded investors, as well as those looking to diversify portfolios overly dependent on fossil fuels -- in case future climate change regulations sprout up.

"We're going to be the forerunner," Chiang said.

But as the state pioneers the bonds, it will navigate a new and unregulated area. Karen Orenstein, senior international policy analyst for Friends of the Earth, an international environmental nonprofit, said no regulatory body manages green bonds to make sure they're actually green.

Massachusetts, for instance, announced in 2015 that it would use some green bond proceeds to build a college parking garage. The justification? Students would burn less fuel scavenging parking spaces around campus.

"Green bonds can be a very important tool to get money flowing to the right things," Orenstein said. But monitoring the bonds, she said, will require "a lot of work."

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Like any bond, green bonds offer investors the opportunity to make a profit by lending money and collecting interest over many years. But entities that issue green bonds -- companies, cities and states -- can only use the borrowed funds toward environmentally beneficial projects, such as renewable energy.

The green bond market has shot up -- exceeding \$40 billion globally in 2015. But California joined the market in its sapling phase.

When the World Bank debuted green bonds in 2008, then-treasurer Bill Lockyer took notice. Lockyer liked the idea of "greening" the state's economy, but he also valued the bonds because they were triple-A rated, lower risk than California's own nongreen bonds at the time, thanks to the state's high debt. "It was safer than our own paper," he said.

California invested an initial \$300 million, and \$1.1 billion over Lockyer's tenure, in the World Bank bonds.

In 2014, California went one step further and began issuing \$300 million of its own green bonds to sponsor sustainable projects. Among projects those bonds funded was one to provide electric power for ships carrying refrigerated goods. Instead of running diesel engines to keep food from spoiling, these ships can now plug in when they dock.

The ships are part of the Good Movement Emissions Reduction Program, which received almost \$44 million from California's green bonds sales.

As part of the same program, the San Joaquin Valley Air Pollution Control District received almost \$3.5 million dollars to subsidize truckers upgrading old, diesel-guzzling vehicles. In 2014, the valley upgraded more than 1,000 heavy-duty trucks.

"It's been great," said Todd DeYoung, the district's manager of grants and incentives. "We are overwhelmed by applications. The truckers want to do the right thing."

Other green bond recipients also focused on emissions -- public transport in San Francisco and Los Angeles received cash -- and a small number focused on water management.

For Chiang, green projects have effects beyond California. "We can make a profound change building a more sustainable world," he said.

But not all green bonds are emeralds. Instead of rules, green bond issuers rely on a set of nonbinding guidelines called the Green Bond Principles, drafted by an international group of issuers and investors.

The lack of third-party monitoring means issuers can label almost anything a green bond. If the bonds' popularity outstrips the number of green projects, issuers could have an incentive to label bonds as green, even when they're not.

Green funding could even flow to fossil fuels, Orenstein said.

"If I wanted to," she said, "I could say, 'I'm making this coal plant less dirty; that's green.'"

Such abuses are uncommon, said Peter Ellsworth, director of the investor program for Ceres, an investing nonprofit that organizes international summits on climate change risk -- the most recent of which Chiang attended in January.

Instead of talking about brown versus green, Ellsworth speaks in terms of "light green" and "dark green." He says the market is evolving, but that differences of opinions about sustainability will always exist.

"If it were to be a highly regulated market, who's going to regulate it?" he said. "Who's got the authority to legislate?"

Indeed, the projects funded by California's green bonds have their own light-green splotches. San Joaquin's diesel trucks, for example, have been upgraded to run on natural gas, a fuel often produced by fracking, which has been tied to air and water pollution.

What's more, the California projects funded by green bonds existed before the bonds were issued. The bonds didn't create any new projects that wouldn't have been funded by another source. Some investors criticize the bonds for that reason.

Chiang said he's aware of the concerns. "We want to make sure that we preserve the integrity of our effort," he said.

Donna Bebb, a research fellow at Stanford's Steyer-Taylor Center for Energy Policy and Finance, called faux-green bonds "a huge risk." But she credits the bonds for attracting new investors to the state.

"The fixed-income investor in me always wants to be a skeptic, but I find myself continuously coming out on the California side," Bebb said. She calls California's green bonds "necessary," though "they're not as warm and fuzzy as washing oil off pelicans."

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