

The Treasury

New Zealand Sovereign Green Bonds Programme Information Release

November 2022

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To: Minister of Finance (Hon Grant Robertson)

Deadline: None
(if any)

Aide Memoire: New Zealand Sustainable Bond Programme

We had agreed with your office to discuss with you a proposal of establishing a central New Zealand Sustainable Bond Programme. This discussion was to be held at WAM on Monday 23 August. Despite WAM having been cancelled for this date, we believe the material is important and likely to be of interest to you.

Attached to this Aide Memoire is the slide pack we have prepared in relation to our proposal. The main points of the proposal include:

- Review of what labelled bonds are
- Request for you to support our suggestion of progressing work towards establishing a Sustainable Bond Programme
- Analysis of potential benefits and limitations of a programme
- Suggested timeline with potential challenges highlighted

Could you please confirm whether you support this work progressing or not?

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TE TAI ŌHANGA
THE TREASURY

New Zealand Sustainable Bond Programme

NZ Debt Management

23 August 2021

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Key Messages

1

We seek your support to progress work towards establishing a centralised New Zealand Government Sustainable Bond Programme

2

The primary rationales for establishing a labelled bond programme relate to investment discipline (ensuring high quality projects are funded and monitored) and market leadership from government, reinforcing government's ambition to address climate related issues. Labelled bonds do not open up new fiscal space

3

Key conditions precedent for a successful labelled bond programme include a large and enduring programme of qualifying projects, appropriate resourcing and cross-departmental support to meet project identification and reporting requirements



Programme expected to be able to be announced in November 2021 with first bonds issued in September 2022.

Review of labelled bonds

Labelled bonds are fixed income securities issued with a label attached to them such as 'Green', 'Social', or 'Sustainable'.

Green bonds raise funds for projects with environmental objectives. For example, energy efficiency, sustainable water and wastewater management, clean transport & climate change adaptation.

Social bonds aim to support projects that address or mitigate a specific social issue and/or seek to achieve positive social outcomes, especially for target populations. For example, affordable basic infrastructure, employment generation projects, food security and sustainable food systems.

Sustainable bonds* direct proceeds to eligible expenditures falling within both eligible Green & Social categories.

Sovereign Sustainable bonds are typically similar to other sovereign nominal bonds, but are labelled 'Green', 'Social' or 'Sustainable' and therefore require the funds raised to be spend on projects that meet relevant criteria.

Sustainable bonds need to be issued from a Sustainable bond framework. This framework requires a structured approach to determining use of proceeds, project evaluation and selection, management of proceeds and reporting.

* This presentation refers to Sustainable bonds. If work in relation to a labelled bond programme progresses, a decision will be made on whether to create a Green Bond Framework or a Sustainable Bond Framework

Why are we talking to you about Sustainable bonds now?

There are currently multiple climate or sustainability related workstreams progressing across the Crown (for example the Government's Emissions Reduction Plan). Within these workstreams, consideration is being given to a number of large capital investments that will require financing. We consider there is an opportunity to set up a Sustainable Bond Programme (SBP); the SBP would support our ability to address these financing requirements centrally, as a complement to standard issuance of New Zealand Government Bonds (NZGBs). The use of an SBP allows us to access our cheapest source of financing, sovereign bonds, while enhancing the investment discipline around expenditure that is recorded through the programme (Eligible Expenditure).

In order to be viable, an SBP need to be significant in size and quality of spend to be enduring and show commitment to genuine additional climate-related expenditure. Once the SBP is fully operational, we estimate a minimum \$10 to \$15 billion of spend would need to be identifiable and committed to over the next four years. At present, central visibility on a pipeline of this scale is low (this view will be noted in advice you will receive shortly on climate funding and financing). We nonetheless consider:

- There are sufficient capital projects in the pipeline to make the creation of an SBP viable. This includes, for example, the potential financing of Waka Kotahi's investment gap in the 2021 NLTP, and future mode-shift transport projects.
- The initiation of an SBP is likely to have benefits in terms of improving the quality of information around the capital investment pipeline.
- The viability of an SBP will depend in part on your fiscal strategy. While decisions have not yet been made, we consider there may be a case to move away from existing net debt constraints where the additional spend is for value enhancing capital investment.

Changing Government policy makes Sustainable bonds more viable

Alignment with government and treasury priorities. Climate has become a priority for both the government and Treasury. It is expected that large amounts of money will be spent in relation to climate in the coming decades. The governance and reporting benefits of a structured framework will add discipline to this expenditure, increasing the likelihood that high value projects are undertaken and well executed. This genuine focus on climate may also reduce risks around 'green-washing'.

Commitment to substantial expenditure in relation to climate. The scale of likely Eligible Expenditure presents an opportunity to create and commit to a SBP. There is flexibility in how Eligible Expenditure is funded. It could be through the standard annual budget allocation process or through a separate funding outside of the usual budget process. We do not see a commitment outside usual Budget process as essential to establishing a SBP. There is flexibility as to the degree to which a SBP could be used as a complement to the Climate Response Fund you are discussing with Treasury and the Ministry for the Environment.

Not all climate related spend will qualify as Eligible Expenditure. There may also be spend that is inappropriate to subject to the governance and reporting requirements of a SBP. It is envisioned that projects included in the SBP will be large scale projects with clear beneficial outcomes.

What has changed since previous advice

NZ specific considerations?

Alignment with the core objective of Treasury's debt management function. There are signs that sovereign labelled bonds are starting to attract a "Greenium" i.e. a premium that investors are willing to pay for labelled bonds. Although the costs of establishing and maintaining a labelled bond programme would be substantial, it is now possible that these may be partially offset, at least in the short term, by reduced borrowing costs.

Liquidity. There has been a dramatic increase in NZGB issuance, outstanding NZGBs and individual bond line caps since the onset of COVID-19. Therefore, we are less concerned that liquidity in our core products will be meaningfully impacted if we spread issuance volumes across additional products.

Diversity of investor base. Feedback we have received from investors and intermediaries, suggests there is likely to be demand from both existing and potentially new investors if we were to issue a labelled bond.

Reputational benefits/risks. "Green-washing" fears have reduced due partly to emerging best practice guidelines, but more importantly because of developing government policy on climate financing. Establishing and committing to a SBP could further strengthen perceptions of the government's commitment to climate policy.

Broader benefits. The Crown could support New Zealand's capital markets by establishing a government "Sustainable curve". Other possible benefits include an improvement in quality of expenditure, due to project selection evaluation criteria, and efficiency of expenditure, due to ongoing monitoring and reporting requirements that would be part of a labelled bond framework.

What has changed since previous advice

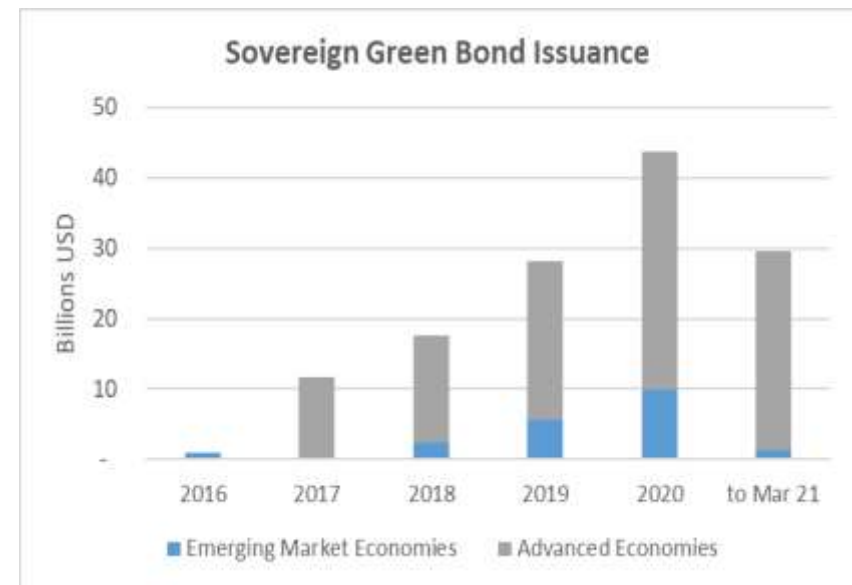
Sustainable bond market?

Exponential growth of Sustainable bond and all other sustainable finance markets. This is being driven by investor demand for debt with Environmental, Social and Governance (ESG) labels and issuer desire to showcase their ESG credentials.

26 Sovereign debt issuers have created labelled bond frameworks since the Polish Government issued the first sovereign Green bond in 2016. The strength of growth of the sustainable bond market and the increasing number of sovereign labelled bond issuances indicate the sustainable bond market is likely to be a significant market for the foreseeable future, not just a passing 'fad'.

Liquidity in sustainable finance market products is steadily increasing with primary markets expansion and improved standardisation.

Market best practice of how a programme framework should be set up and maintained has evolved such that guiding principles are emerging. If followed, these best practice principles can increase investor confidence in the substance of a labelled instrument and reduce the risk to an issuer being accused of "green-washing".



Potential benefits & limitations of Sustainable bonds

Potential Benefits of Sustainable bonds

- The discipline, transparency and governance of project selection, monitoring and reporting along with independent assurance required with a Sustainable Borrowing Programme
- Long term commitments to expenditure and to the Programme will need to be made
- Supporting New Zealand's capital markets development, especially if a "Sustainability curve" is able to be established
- Diversification of investor base
- Shining a light on the NZ government's climate related work & commitments

Potential Limitations of Sustainable bonds

- The costs and administrative effort of establishing and maintaining a Sustainable Borrowing Programme are expected to be substantial
- Not all Climate related spend is likely to qualify as Eligible Green Expenditure
- There may not be a pricing benefit to issuing Green bonds compared to conventional NZGBs

Where are labelled bonds not different to conventional NZGBs:

- Whether bonds are issued by the Crown as conventional NZGBs or Sustainable bonds, the impact on net debt is identical.
- It is not expected that issuing Sustainable bonds would give the Crown access to funds that are otherwise unavailable, as there is currently no restriction on available funding.

Initial thoughts on SBP structure

Structure provided through SBP would support investment discipline



Sustainable Financing

- Sustainable bonds can finance climate and social related expenditure
- Funding will be from existing sources of revenue

Consolidated Account

- The Treasury's debt management transfers proceeds to consolidated account
- Proceeds must be allocated within a certain period of time (e.g. four years, with allocations up to one year prior to bond issuance being generally acceptable by investors)

Investment Framework and Governance

- Governance group implements and maintains the sustainable financing framework (e.g. Treasury, Ministry for the Environment, Ministry of Transport, MBIE)
- Assessment of eligible projects
- Dedicated tracking process to "follow the money"

Sustainable Projects

- Allocation to individual projects
- Assurance process to monitor spending and impact

Investment Frameworks

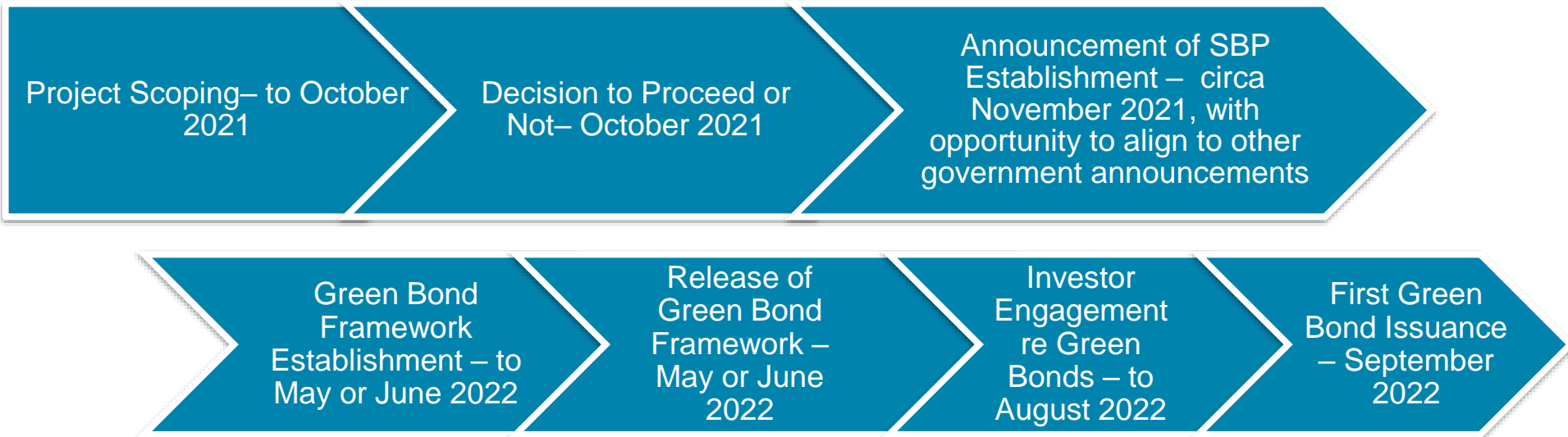


Example Spend Category: Clean Transportation



- Significant volume of qualifying projects in transport (\$1,600m in current NLTP for PT infrastructure and walking/cycling, WK requesting further investment)
- A number of large potential mode-shift projects in development
- Labelled bond would be raised centrally, DM can 'on-lend' to WK

Next steps & timing



Project scoping considerations include:

- Ensuring key issues in relation to resourcing, project identification and cross-departmental support are addressed.
- Collaboration will be required across government departments to set up the programme, select and monitor projects and report.
- Setting up a framework which aligns with existing government policies, including wellbeing budget, LSF, net zero ambition and UN Sustainable Development Goals
- Creating a working group for establishment of Sustainable Bond Framework
- Creating a long term governance group to manage ongoing requirements
- Estimation of project cost
- Development of reporting
- Details of bonds to be issued