

The Treasury

New Zealand Sovereign Green Bonds Programme Information Release

November 2022

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Office of the Minister of Finance

Chair, Cabinet Business Committee

New Zealand Green Bond Programme

Proposal

- 1 This Government has an ambitious agenda to work to a low emissions future. As part of that agenda, I am proposing to create a sovereign 'Green Bond' Programme (GBP).
- 2 I seek Cabinet support to take a two-stage process in developing the GBP. As the first step, I am proposing to announce the creation of the programme at the 26th Conference of the Parties to the United Nations Framework Convention on Climate Change (COP26), in November 2021. This announcement will enable Officials to engage with the market on the structure of the programme. As the second step, I intend to report back to Cabinet in April 2022 with a final proposal for the GBP.

Executive Summary

- 3 Climate change is one of the greatest challenges of our time. This Government is committed to decisive action on climate change, as shown through the work we are currently undertaking to set New Zealand's first Emissions Reduction and National Adaptation Plans (ERP and NAP). We know that credible action to address climate change adaption and mitigation is hugely important to New Zealanders. Our response to climate change will require us to make good long-term investments and have access to a range of financing options to support these.
- 4 As a next step in our continuing journey to meaningfully address climate change, I am seeking your support to create a sovereign GBP. The programme would sit in New Zealand Debt Management (NZDM), within the Treasury. Green Bonds provide 'financing'¹ for projects. They do not provide a new source of 'funding' and will not provide any additional fiscal headroom relative to the current approach of issuing New Zealand government bonds. I have summarised the New Zealand government bond issuance programme in [Annex 1](#) to this paper.
- 5 In my view, the creation of a sovereign Green Bond programme has the potential to provide significant benefit. The projects financed by Green Bonds will be subject to additional scrutiny and will need to demonstrate positive

¹ Funding refers to the revenue sources from which public expenditure is ultimately met. This can include user charges, as well as local rates and appropriation from general taxation. Financing relates to how the timing of the expenditure outlay, and the receipt of the funding to support it, are to be matched in time (i.e. it does not provide a new source of funding). Financing enables current investment expenditure to be funded from future revenue sources.

environmental outcomes. Over time, the project selection, evaluation, and reporting requirements that come with a Green Bond programme will help to ensure high-quality projects with robust environmental outcomes are being financed and delivered. This is particularly important given the significant amount of investment that will be required by the government to support the climate transition.

6 Green Bonds will also help to support the development of New Zealand's sustainable finance market, particularly if a 'green curve' is able to be developed.

7 I have been interested in the possibility of the Crown issuing Green Bonds for several years. Historically, Officials have had a degree of scepticism that Green Bonds would provide value as a financing option, relative to the issuance of conventional New Zealand Government Bonds (NZGBs). Recently, however, there have been several market developments that have swung the case in favour of establishing a programme, including:

7.1 A substantial increase in NZGBs on issue, meaning the creation of a GBP would have a more limited impact on NZGB liquidity.

7.2 Sovereign debt issuers around the world have embraced issuing Green Bonds. More than 20 sovereign issuers have established programmes that allow them to issue Green Bonds. A number of New Zealand entities, including Auckland Council, Mercury Energy, Contact Energy and Kāinga Ora have also issued Green or other labelled bonds.

7.3 There is substantial and growing investor demand for sovereign Green Bonds, reflecting an increase in the number of investors with mandate to invest in Green Bonds and the development of accepted market best practice. While Officials consider it likely that Green Bonds will price similarly to NZGBs in the long-term, in the short-term investors have been willing to pay a premium for Green Bonds (a so-called 'greenium'). Most recently the UK Debt Management Office attracted £100 billion of orders for their inaugural Green Gilt issuance of £10 billion.

The Green Bond Programme

Proposed features

8 I am proposing that the GBP will follow market best practice to support investor confidence in the integrity of the programme. This is expected to involve aligning the GBP with internationally recognised principles and practices. For example, identifying how eligible expenditure is likely to contribute to the United Nations' Sustainable Development Goals (UN SDGs).

9 Demonstrated coherence in eligible expenditure categories, and their expected impact outcomes, with broader government strategic sustainability priorities is an important consideration in establishing a framework. Additionally, issuers typically commission an independent report, known as a 'Second Party Opinion' (SPO), to review and comment on the structure of the programme.

- 10 Officials will also consider how to incorporate 'New Zealand specific' elements into the GBP, such as incorporating a Te Ao Māori perspective through the application of the He Ara Waiora framework.
- 11 A detailed description of how a GBP is expected to operate is outlined in [Annex 2](#) to this paper.

Proposed approach to issuance

- 12 I am proposing that the Green Bonds would be issued centrally by NZDM. Although it may be possible for government agencies outside of NZDM such as the NZ Green Investment Fund (NZGIF) and Waka Kotahi to issue bonds, I do not consider this to be the right approach. This reflects the following judgements and objectives:
 - 12.1 Financing at minimum cost,
 - 12.2 Demonstrating market leadership and providing support for New Zealand's capital markets development,
 - 12.3 Providing a stronger statement in relation to the Government's climate commitments and being more closely aligned with other Government responses, such as the ERP or NAP, and
 - 12.4 Ensuring that the GBP is of sufficient size to remain liquid, relevant, enduring and credible.
- 13 A GBP needs a significant ongoing volume of issuance to remain attractive to investors. Direct issuance by other agencies is unlikely to provide this volume and will reduce the pool of projects able to be financed centrally. A centralised programme gives Ministers flexibility of including a broad range of climate projects from across government.

Integration with existing decision making and reporting processes

- 14 Although the creation of a GBP will not change existing or contemplated decision-making processes for funding projects, it will create additional requirements for assessing project eligibility and reporting. For this data to be collected centrally, the Treasury will need to make system changes or build new processes. Higher expectations will also be placed on government agencies.
- 15 In the short-term (for example, the 2022/23 financial year), as GBP development occurs in parallel with the Budget, a tactical approach to determining project inclusion will be adopted. This means criteria for GBP inclusion will be determined after agencies have developed Budget bids, and possibly after Budget decisions have been made.
- 16 As a result, project identification, evaluation, and selection will occur outside of the Budget process. This could involve the Treasury identifying a small number of large-scale projects for inclusion in the GBP. Inclusion of these projects will be considered by delivery agencies and relevant Ministers. After agreement for

inclusion, the Treasury will work with agreed delivery agencies to develop the necessary reporting processes.

- 17 While a tactical approach will help reduce risk for 2022/23, using this approach for an extended period may generate reputational risk for the Crown. For a GBP to be credible, a more structured and systematised approach to project identification, evaluation, and reporting will be required. Improvements in these disciplines is one of the key benefits of an GBP, helping to ensure high value projects are undertaken and well-executed.
- 18 Work is ongoing to determine how integration might be achieved between a GBP and reporting and data collection requirements either in place (for Budget) or being contemplated (for example for the Climate Emergency Response Fund (CERF) or through work on Public Finance Modernisation). An increase in system capacity may be required, both within the Treasury and agencies. Investment options could range from making the improvements necessary solely for the GBP to broader cross government system improvements which would result in improved transparency and tracking of projects and expenditure across government.

Connections to other work underway

- 19 In June 2021 Cabinet directed the development of an approach to funding and financing the transition to a low emissions and climate resilient future [CBC-21-MIN-0060 returns]. I will be updating Cabinet on this work programme later this year on the issues identified in the establishment of that programme.
- 20 The Government is currently developing its first Emissions Reduction Plan. This must be published by the 31 May 2022 and will include a chapter on Funding and Financing the transition. We will look to use that chapter to provide an update on the bond programme as appropriate.
- 21 Under the Climate Change Response (Zero Carbon) Act government is required to set out a National Adaptation Plan detailing how New Zealand will adapt to the risks and impacts of climate change. Government is currently developing the first National Adaptation Plan ahead of publication mid-next year.
- 22 We expect some projects in the first and future Emissions Reduction and National Adaptation Plans to be financed by Green Bonds.

Timeline

- 23 Consideration of a GBP is market sensitive information. Until a public announcement has been made Officials are restricted in their engagement with stakeholders and advisors on the establishment of the programme. With this in mind, I intend to announce the intention of Sovereign Green Bond issuance in early November.
- 24 At this stage of the project it is difficult to determine all milestones and when those milestones will need to be completed. At a high level, Officials are currently working to a timeline that incorporates the following key targets:

Date	Action
<i>November 2021</i>	Public announcement that the Crown intends to issue Green Bonds. Possibly to align with COP26 (31 October 2021 to 12 November 2021), or APEC Minister's meetings taking place in the week commencing 8 November 2021.
<i>December 2021</i>	Appoint banks as structuring advisors to programme establishment
<i>March 2022</i>	Use of proceeds categories, criteria for project selection, monitoring and reporting processes established
<i>April 2022</i>	Report-back to Cabinet re: GBP framework and interaction with budget and funding decision making
<i>May 2022</i>	Documentation, including the Green Bond framework, Second Party Opinion and an investor presentation finalised
<i>June 2022</i>	Public release of documentation
<i>August 2022</i>	Public announcement of details of inaugural Green Bond
[37]	

Risks

25 Beyond the risks and investment identified around reporting processes, other challenges will need to be managed, such as:

25.1 Scale of near-term projects. A viable GBP programme will require sufficient volume of issuance to support secondary market trading and investor confidence in the longevity of the programme. The Treasury has confidence that there are sufficient large-scale projects to provide this scale over time but note there is heightened risk in the short-term.

25.2 Timing risk around first issuance. Clearly defined government targets, as well as strategies to meet those targets, support development of Use of Proceeds categories. They also support SPO assessments. With the Government's first Emissions Reduction Plan not expected to be finalised until May 2022, it may be challenging to align government

strategies and use of proceed categories ahead of this time. This could raise risks to a timeline anticipating first issuance in September 2022.

The Role of Ministers

- 26 Coordination and cooperation across agencies will be imperative to ensure projects are able to be identified and their expected impacts are well understood and monitored. The inclusion of a project in the GBP will place a reporting requirement on the agency responsible. Ministerial support will be required to ensure agencies are incentivised and resourced to develop projects that may be eligible for inclusion in the programme.
- 27 Detailed processes on how a programme will work are yet to be determined. At this stage it is envisioned that a non-ministerial governance committee will assess project eligibility, “tagging” budget bids and other projects as Green bond eligible where appropriate. Ministers, when making funding allocation decisions will be able to see where projects are Green bond eligible.
- 28 As work progresses, I will update Ministers through the Climate Ministers Response Group on both the proposed operation of the programme and the type of support I require from them.

Financial Implications

- 29 The Treasury’s indicative view is that the development of an GBP and the processes to support the first issue of an GBP will come at direct cost of approximately \$1 million. The estimate assumes we take the tactical approach noted above and excludes the cost of reporting and longer-term integration for project selection, monitoring and reporting. To the extent possible, Treasury intend to meet establishment costs within the current funding profile of the Administration of Crown Borrowing, Derivatives Transactions and Investment Permanent Legislative Authority departmental PLA.
- 30 Development of the systems necessary to integrate the GBP into the Budget and reporting processes set out in this advice will take time and require additional resourcing. Consideration will begin to be given to integration needs as part of the Treasury’s upcoming Budget bid.

Legislative & Human Rights Implications

- 31 This paper has no legislative or human rights implications. No regulatory impact analysis is required.

Consultation

- 32 To date there has been limited departmental consultation due to the sensitive nature of the subject. Once a public announcement has been made, relevant departments will be contacted to discuss the programme and the implications for their department.

Communications

- 33 I intend to make an announcement in relation to issuing Sovereign Green Bonds in early November. The communications approach will be managed by my office, in consultation with other entities as appropriate.
- 34 We will also look to reflect the bond programme through the Funding and Financing chapter of the upcoming Emissions Reduction Plan.

Recommendations

The Minister of Finance recommends that the Cabinet:

- 1 **Agree** to the establishment of a sovereign Green Bond Programme, which will allow the Crown to issue New Zealand Government Green Bonds.
- 2 **Agree** to support a tactical approach to identifying, monitoring and reporting on eligible projects initially, with a view to develop more robust, systematic processes as expediently as practicable.
- 3 **Note** that coordination and cooperation across agencies will be imperative to ensure projects are able to be identified and their expected impacts are well understood and monitored.
- 4 **Note** that Ministerial support will be required to ensure agencies are incentivised to develop projects that may be eligible for inclusion in the programme.
- 5 **Note** that higher expectations will be placed on government agencies in relation to project monitoring and reporting and that this is likely to result in additional resourcing requirements.
- 6 **Note** the establishment of a Green Bond Programme is not contingent on other climate and infrastructure decisions, however alignment with broader advice and structures will be considered to avoid unnecessary complexity and duplication.
- 7 **Note** there are challenges to aligning a Green Bond Programme to government policies and strategies which are still in development, such as the ERP.
- 8 **Note** Green bonds provide 'financing' for projects. They do not provide a new source of 'funding' and will not provide any additional fiscal headroom relative to the current approach of issuing New Zealand government bonds.
- 9 **Note** projects financed by Green Bonds will be subject to additional scrutiny which will help to ensure high-quality projects are being financing and delivered over time.

Authorised for lodgement

Hon Grant Robertson
Minister of Finance

Annex 1: Overview of the New Zealand Government Bond Issuance Programme

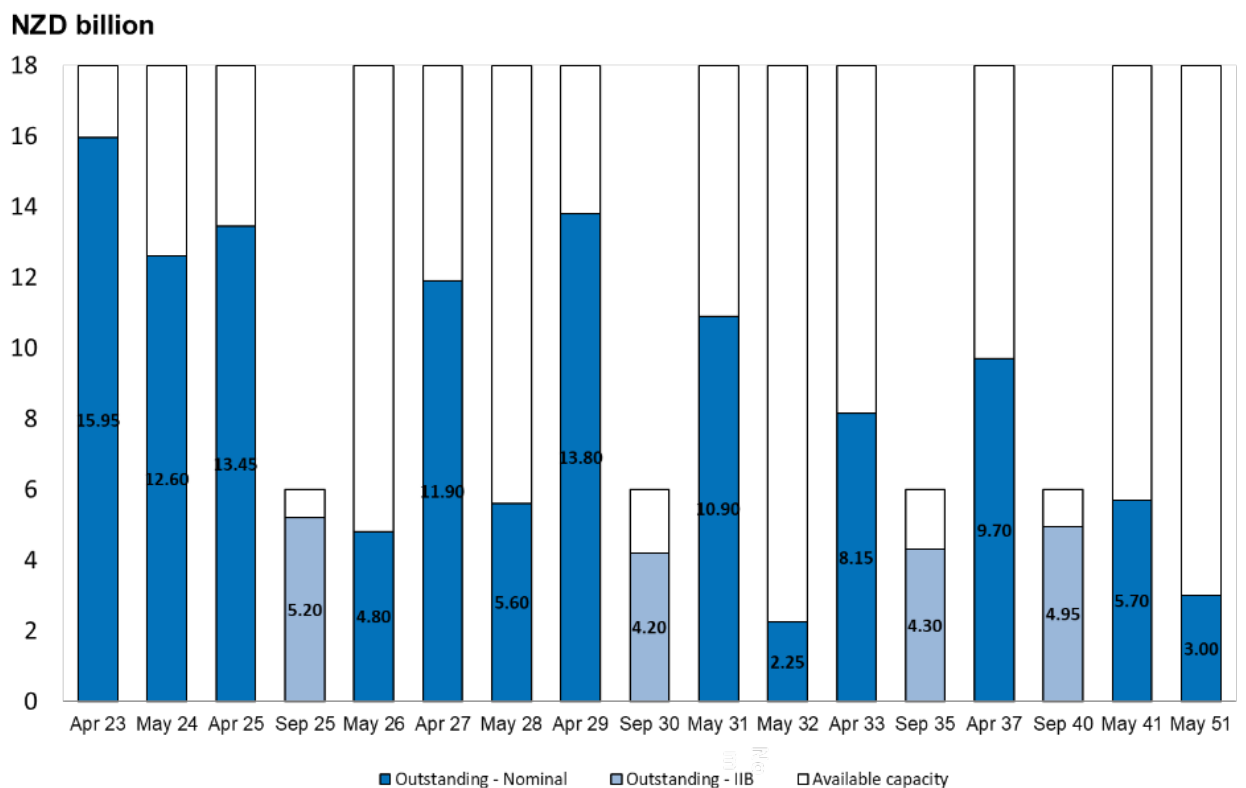
Each year the Treasury forecasts how much the Government is likely to earn, and how much it will need to spend. This usually happens twice a year, at Budget in May and again in December. In an election year, an additional update is provided just prior to the election.

These forecasts will establish whether there is a cash deficit or a cash surplus and will include advice to the Government on how much will need to be borrowed. Once the borrowing needs are determined, a borrowing programme is agreed with the Minister of Finance. New Zealand Debt Management (NZDM), a function within the Treasury responsible for managing the borrowing programme, then conduct regular, planned borrowing over the period of a year.

NZDM's primary responsibility is the efficient management of the Crown's debt and associated financial assets within an appropriate risk management framework. The maintenance of a well-functioning New Zealand Government Bond (NZGB) market is central to this remit. NZDM manages the issuance of NZGBs, including nominal bonds and inflation indexed bonds (IIBs). At 30 September 2021, there were NZD 136.4 billion of nominal and inflation-indexed bonds outstanding (*Figure 1*).

Figure 1. Outstanding NZGBs and Capacity for Issuance – 30 September 2021

Source: Treasury

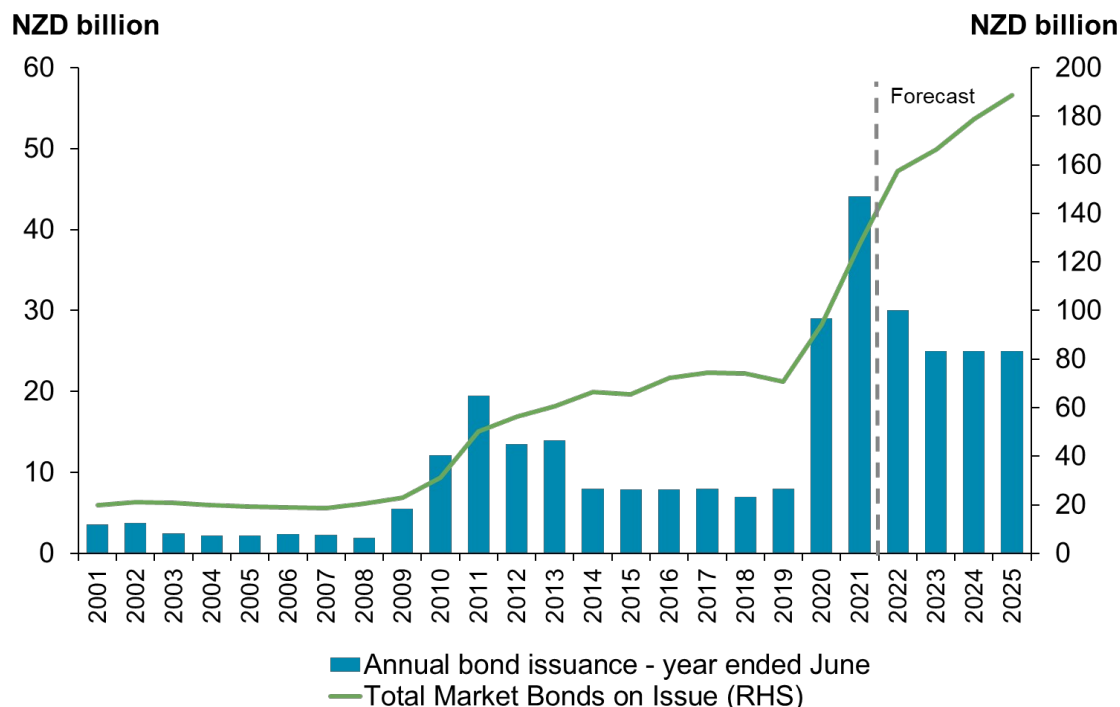


The Economic and Fiscal Update (EFU) announcements contain a breakdown of the annual bond issuance forecasts. As announced at BEFU 2021, over the five-year

forecast period, total outstanding bonds are projected to increase to NZD 189.4 billion (Figure 2).

Figure 2. Forecast NZGB issuance (BEFU 2021)

Source: Treasury



Syndications² are typically used to issue a new bond to the market. Historically, one to two syndications were undertaken annually and they were confined to launching new bonds. However, higher annual borrowing programmes led to an increase in frequency, with four new bonds and one ‘tap’ of an existing bond line issued via syndication in 2020/21. Alongside BEFU 2021, two bond syndications for the 2021/22 fiscal year were announced.

The secondary market is supported by major local banks and global intermediaries. In the secondary market, NZGS are bought by a range of investors including, fund managers, insurance companies, Central Banks, and pension companies. Approximately half of all NZGS are held by New Zealand investors with the remainder held by offshore investors. There is a repurchase market for NZGBs and the RBNZ also offers a bond lending facility as a lender of last resort.

NZGB yields have historically traded above global developed market peers. In terms of absolute levels, NZGB yields have been on a declining trend in recent decades, in line with the global disinflationary trend. However, yields have increased over 2021, reflecting expectations of higher inflation and monetary tightening.

² Syndications are a process where NZDM enlist a panel of RTCs to help launch a new bond. Syndications remain the preferred method for the issuance of new bond lines, as it enables the placement of a large initial volume into the market, promoting immediate liquidity in the new bond.

Annex 2: Operation of a Green Bond Programme

Officials' initial expectations are that the GBP would work as follows:

- The Treasury, in consultation with external advice, will recommend the framework for the GBP, including defining eligible project categories (Use of Proceeds).
- Agencies will identify large scale projects that have environmental and/or social benefits.
- The programmes or projects identified will be evaluated by a governance committee, using clearly defined project evaluation criteria to determine whether they would be eligible to be included in the GBP (Process for Project Evaluation and Selection). Those projects that are eligible will be 'tagged' as Green bond eligible. The committee would comprise officials and potentially independent experts, rather than Ministers.
- When projects are considered for funding, the 'tag' of eligibility will be visible to decision-makers (for example Ministers in the case of the Budget).
- As Green bonds are issued, projects with expenditure expected to occur in a defined time period, known as an 'expenditure window', will be selected from the eligible project pool as projects that will be financed by the Green bond issuance.
- Proceeds raised from Green bonds will be earmarked as Green bond proceeds. Money spent on projects in the eligible project pool will be tracked. (Management of Proceeds).
- Regular meetings, possibly semi-annually, will be held by a governance or oversight committee. This committee will ensure the programme is running effectively, approve projects to be added to the eligible pool of projects and review reporting information prior to publication. Reporting is expected to involve reporting on allocation of proceeds and reporting on the expected and/or achieved impact of the projects. Frequency of reporting is yet to be determined but is likely to be annual or biennial. This reporting will be externally assured. (Reporting).

The Treasury will be responsible for portfolio strategy, issuance, risk and operational aspects of the programme (through New Zealand Debt Management). They will monitor investor feedback, government strategies and market developments, adjusting the programme as required to ensure it remains supported by stakeholders.