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Climate Finance – Opportunities in the Unlabelled Universe of Bonds

Climate finance and ESG-themed bonds have been dominating the market with issuers taking advantage of the so-called "greenium". "Greenium" is where green bonds are issued at a higher price while offering investors a lower yield. In other words, issuers benefit from a lower cost of funding. This is more prevalent in the USD market while in Asia, such bonds have recently picked up pace. Despite being nascent, we have seen a rapid growth in green, social and sustainability and sustainability-linked ("GSSSL") labelled issuances denominated in SGD. Collectively, we call them the GSSSL market for simplicity at OCBC Credit Research rather than listing out all the different labels. If you have been following our podcasts and writeups, you would have heard and read about sustainability-linked bonds ("SLBs") issued by Sembcorp Industries Limited and Nanyang Technological University. SLBs are a type of debt instrument which incentivise issuers or borrowers to achieve pre-determined sustainability performance targets (SPTs), and often these are "unlabelled".

Climate-aligned issuers are issuers that derive at least 75% of their revenues from climate-aligned business activities. As a growing climate-aligned bond market is necessary to redirect capital and investment flows towards activities that promotes sustainable development, we take a closer look at unlabelled bonds in the climate-aligned bond universe – how unlabelled issuances are defined, accounted for, who are the issuers and what opportunities entail under this unlabelled umbrella.

Definitions of Climate Aligned Issuance

Definitions are based on a Climate Bonds Taxonomy issued by the Climate Bonds Initiative ("CBI"). CBI is an international organization promoting investment in projects and assets necessary to facilitate transition to a low carbon and climate resilient economy. CBI also runs the Climate Bonds Standard and Certification Scheme providing certification to eligible issues. There are various benefits to obtain a certification. For issuers, a label allows them to demonstrate to the market that the bond issued meets climate integrity or is aligned with Paris Agreement of 1.5 degrees Celsius warming target. This attracts a more diverse base of investors. Investors armed with disclosures from the issuers can make more informed investment decisions in line with their mandates and proactively hedge their portfolio against climate risk. To be defined as a climate-aligned bond under CBI's taxonomy, assets and projects are to feature at least one of these eight broad categories, namely, energy, transport, water, buildings, land use & marine resources, industry, waste and information, communication & telecoms (ICT).

For labelled green bonds, issuers are usually green pure plays where all or most of their revenues are derived from green activities or other sustainable activities. Additional certification is obtained to differentiate their bond issuance to provide extra visibility for investors when doing due diligence before making an investment decision. Certifications can be obtained from CBI or other organisations like International Capital Market Association. At the same time, the unlabelled category contains fully-aligned climate issuers where they derive >95% of revenues from climate-aligned assets and green business lines and strongly-aligned climate issuers where 75%-95% of their revenues derived from climate-aligned assets and green business lines. These climate-aligned issuers may and or may not have labelled bonds. However, for the purpose for this writeup, we are only focusing on the unlabelled climate-aligned bonds universe.

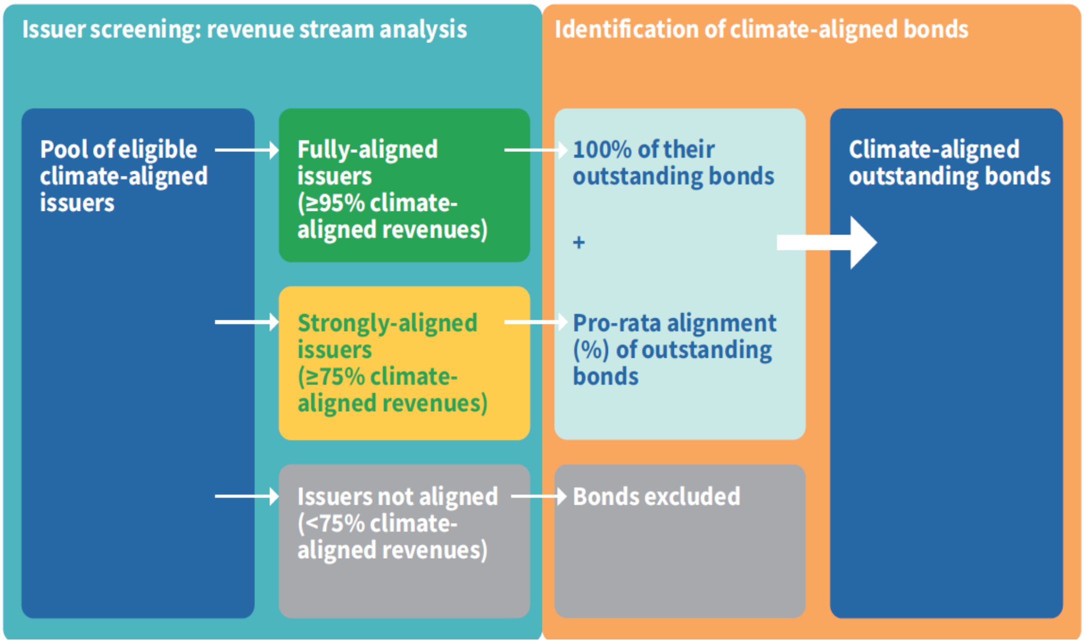
Table 1: Categories of Climate-aligned Issuers

Label	Climate-aligned Issuers	Definitions
Labelled	Green Bond	Green pure plays where all or most of their revenues are derived from green activities
Unlabelled	Fully-aligned Climate Issuer	>95% of revenues from climate-aligned assets and green business lines
	Strongly-aligned Climate Issuer	75%-95% of their revenues derived from climate-aligned assets and green business lines

Source: Climate Bond Initiative, OCBC Credit Research

In an annual report, CBI identified a universe of USD913.2bn of unlabelled but climate-aligned bonds, this amount is about 50% of the total labelled volume of USD1.7 trillion in 2020. For investors searching for investments to meet their ESG mandates, these unlabelled bonds may be seen as hidden treasures. **Figure 1** below adapted from the CBI report better illustrates how the outstanding climate-aligned bonds are identified.

Figure 1: CBI Climate-aligned Bonds Methodology

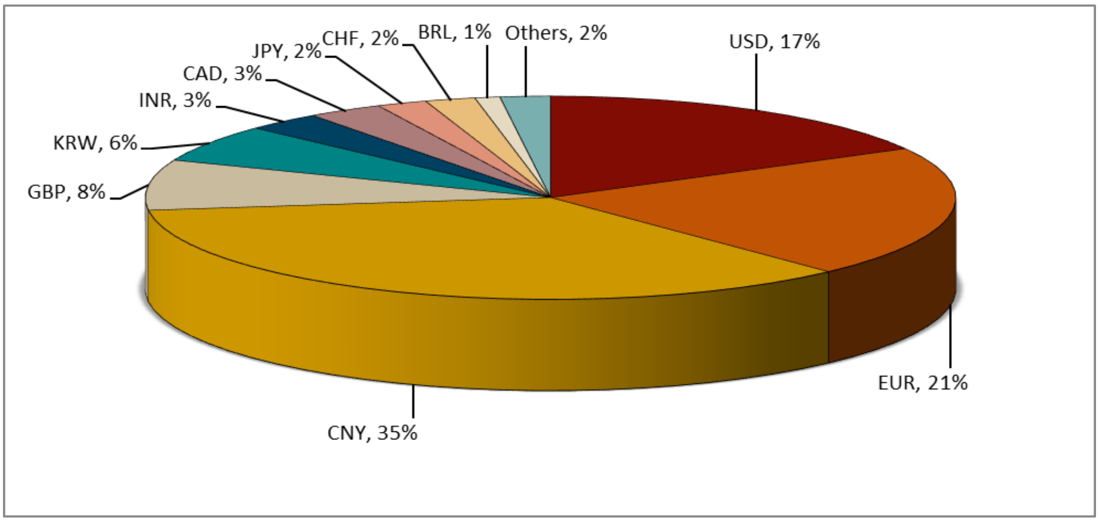


Source: Climate Bond Initiative

Global Landscape of Unlabelled Climate-Aligned Bonds

The USD913.2bn outstanding climate-aligned bonds is derived from 420 climate-aligned issuers identified, based on the methodology above. Of these, 311 are fully-aligned issuers while the rest falls under the strongly-aligned category. These issuers span across 45 countries, issuing in 33 different currencies. Developed and emerging countries take up almost equal share, 50% and 49% respectively with 1% issued by one supranational institution EUROFIMA with USD8.8bn of bonds outstanding. Popular currencies with issuers are USD, EUR, GBP and CNY. 52% of the outstanding bonds are issued in hard currency, CNY is nonetheless the top currency with 35%. CNY bonds also account for the largest share in soft currency. A hard currency usually originates in a robust economy under stable political governance whereas soft currency is one that fluctuates due to country's uncertain political or economic landscape. Hard currencies are considered more valuable as compared to soft currencies. Chart below shows a breakdown for all the currencies where data is obtained from CBI's 2020 report.

Figure 2: Unlabelled Climate-Aligned bonds breakdown by currencies

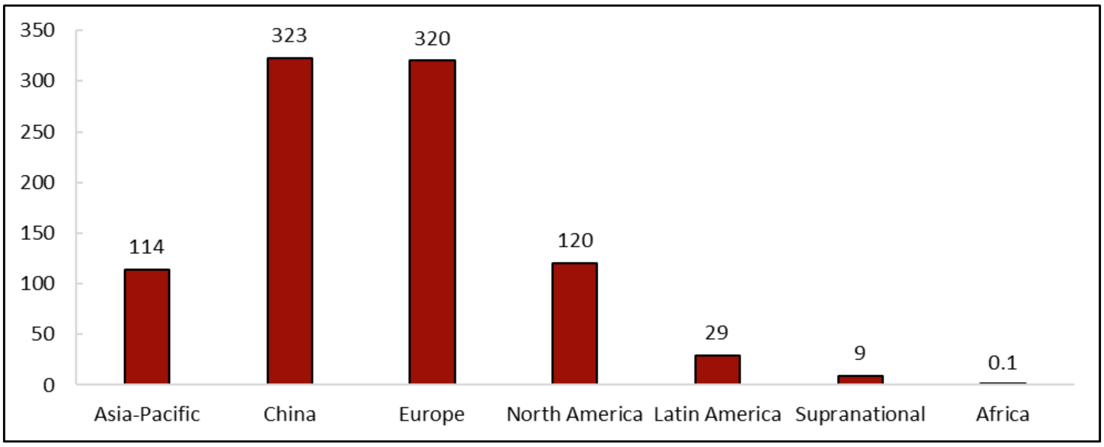


Source: Climate Bond Initiative (Data from 2020)

The Asia-Pacific region ("APAC") is the largest contributor globally for climate-aligned bonds. Being the region with sizeable issuance, it accounts for 36% or USD325bn of global market share. Issuances from APAC is concentrated in China and represents 74% of APAC's total. One of the largest issuances is by China Railway Corp (USD230bn) who is a strongly-aligned issuer as its non-green revenues generated from real estate and highway infrastructure are slightly more than 5%. Stripping China out from Emerging Market ("EM"), EM accounts for 14% of global outstanding climate-aligned bonds. It is relatively low as compared to Developed Market ("DM") and China. Main issuers in EM are Korea Electric Power Corporation, Indian Railway Finance Corporation and Electrobras SA.

The European region came in second with France leading the way in the DM space. Top issuers are Société Nationale des Chemins de fer Français (SNCF) at USD53.7bn and Electricite de France (EDF) at USD52.1bn. North America ranked third with USD119.7bn contributed by 65 issuers.

Figure 3: Unlabelled Climate-Aligned Universe by Region (USDbn)



Source: Climate Bond Initiative (Data from 2020)

Sectors that dominate un-labelled hidden climate-aligned capital are transport and energy. For transport theme climate-aligned bonds, railway transport in particular accounts for 90% of total climate-aligned outstanding bonds. In APAC, these issuers are usually government linked entities like China Railway Corp, Indian Railway Finance and Korea Rail Network Authority. Top transport issuers in Europe are SNCF, Deutsche Bahn and OeBB-Infrastuktur. This mode of transport is important as electrification of high-speed rail will be able to replace short-haul flights and scale up low carbon transportation. Other sub-sectors in transport are made up of electric and hybrid vehicles, public transport, shipping and bicycle and electric vehicle ("EV") charging stations. In DM, Tesla has the biggest market share in EV while the uptake of EVs in EM faces roadblocks with insufficient charging points and unreliable power sources. Policies and private capital will be required to support growth in this area even though most capital may be channelled to industry and sectors that have been adversely impacted by COVID-19 pandemic.

For the energy sector, capital raised is more predominant in Europe and North America especially in the renewable energy mix sub-sector. The total outstanding bond volume in the energy DM sums up to USD108.8bn. Issuers seen in this sector are Hydro-Quebec, Vattenfall and Orsted. In EM, South Korea and Colombia led the energy climate theme with USD62bn in outstanding climate-debt. Top issuers are Korean Electric Power Corp, Korea Hydro Nuclear Power Co and Empresas Publicas de Medellin E.S.P (EPM). Similar to DM, the renewable energy mix is amongst the top energy climate sub-sectors with USD40.2bn outstanding bonds for EM. Looking at China as a standalone, it has USD48.5bn outstanding climate-aligned bonds in the energy sector, where 56% of this bond volume is issued by China National Nuclear Corp, China Three Gorges Corp and China Yangtze Power collectively.

The Singapore Context

According to CBI, bonds and issuers that are climate-aligned in Singapore generally are from the real estate sector. Issuers like CapitaLand Ltd and Frasers Property Ltd fall under the top 20 best performing property companies globally. As of writing, there are twelve outstanding bonds where seven are issued in SGD by three subsidiaries of Frasers Property Ltd. Per Bloomberg's sustainability debt indicator, of the twelve issues, only one issued by Frasers Property AHL is labelled sustainability. It is a senior unsecured bond of SGD300mn. Meanwhile, all outstanding bonds under CapitaLand Limited that are issued by CapitaLand Ltd or CapitaLand Treasury Ltd are not labelled with Bloomberg's green indicator. As there are considerable needs for real estate companies to meet green building standards and improve on their green footprints, it will be beneficial when these issuances are refinanced with the green label upon maturity.

Table 2: Outstanding Bonds under CapitaLand and Frasers

Issuer	Coupon (%)	Maturity/ Call Date*	Currency	Amount Outstanding (mn)
CapitaLand Treasury Ltd	3.65	17/10/2024*	SGD	500
	3.15	29/08/2029	SGD	800
	4.076	20/09/2022	USD	400
	3.08	19/10/2027	SGD	500
	2.9	21/09/2032	SGD	800
	3.8	28/08/2024	SGD	500
CapitaLand Ltd	2.8	08/06/2025	SGD	10.25
	1.95	17/10/2023	SGD	22.25
Frasers Property Treasury Pte Ltd	4.98	11/04/2024*	SGD	600
	3.95	05/10/2022*	SGD	350

	4.15	23/02/2027	SGD	500
	4.38	17/01/2023*	SGD	300
	4.25	28/08/2024	SGD	280
	3.65	22/05/2022	SGD	500
Frasers Property AHL Ltd	3.00	09/10/2028	SGD	300
Frasers Property Holdings Thailand Co Ltd	3.02	17/08/2022	THB	2300
	2.94	21/12/2024	THB	2500
	3.88	17/08/2028	THB	1200
	3.54	07/03/2028	THB	2000
	2.55	07/03/2023	THB	1000

Source: Bloomberg
[1]FPLSP SGD300mn 3%'28s sustainability bond issued in September 2021

Labelled Opportunities

Based on our calculations using CBI data from 2020, approximately USD373bn of outstanding unlabelled climate-aligned bonds are due for maturity in 2024. Usually, these unlabelled issuances are difficult to identify thus with upcoming maturity, it presents an opportunity for these issuers to refinance and label their debt from vanilla to green. Although some climate-aligned issuers have already entered the labelled green bond market, there remains further room for issuers to label their debt.

So, should investors be interested in the unlabelled universe of bonds?

Indeed, tapping into the labelled green market provides better transparency in this nascent and fast-evolving market where both issuers and investors stand to benefit.

For investors, almost all climate-aligned issuers are rated investment grade by both international and local rating agencies. Only a small percentage of approximately 5% are unrated or falls into the high yield space. This presents good quality asset choices for investors to add on to their portfolios in accordance with ESG mandates and insulate it from adverse climate transition and physical risks. For the issuer, apart from a potentially lower cost of debt through the greenium, being certified with the green label strengthens internal corporate integration with sustainability, provides new engagement, increases visibility and market opportunities and enhances its reputation. In addition, with the possible changes in policies to expand the GSSSL market, policymakers and central banks may even start accepting smaller haircuts when accepting these assets as collateral. For example, the central bank of China, PBoC has already included green bonds in their collateral framework, accepting lower rated (AA, AA+) green bonds and green loans as collateral for its Medium-Term Lending Facility.

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Explanation of Issuer Profile Rating / Issuer Profile Score

Positive ("Pos") – The issuer's credit profile is either strong on an absolute basis, or expected to improve to a strong position over the next six months.

Neutral ("N") – The issuer's credit profile is fair on an absolute basis, or expected to improve / deteriorate to a fair level over the next six months.

Negative ("Neg") – The issuer's credit profile is either weaker or highly geared on an absolute basis, or expected to deteriorate to a weak or highly geared position over the next six months.

To better differentiate relative credit quality of the issuers under our coverage, we have further sub-divided our Issuer Profile Ratings into a 7 point Issuer Profile Score scale.

IPR	Positive		Neutral			Negative	
IPS	1	2	3	4	5	6	7

Please note that Bond Recommendations are dependent on a bond's price, underlying risk free rates and an implied credit spread that reflects the strength of the issuer's credit profile. Bond Recommendations may not be relied upon if one or more of these factors change.

Explanation of Bond Recommendation

Overweight ("OW") – The bond represents **better relative value** compared to other bonds from the same issuer, or bonds of other issuers with similar tenor and comparable risk profile.

Neutral ("N") – The represents **fair relative value** compared to other bonds from the same issuer, or bonds of other issuers with similar tenor and comparable risk profile.

Underweight ("UW") – The represents **weaker relative value** compared to other bonds from the same issuer, or bonds of other issuers with similar tenor and comparable risk profile.

Other

Suspension – We may suspend our issuer rating and bond level recommendation on specific issuers from time to time when OCBC is engaged in other business activities with the issuer. Examples of such activities include acting as a joint lead manager or book runner in a new issue or as an agent in a consent solicitation exercise. We will resume our coverage once these activities are completed.

Withdrawal ("WD") – We may withdraw our issuer rating and bond level recommendation on specific issuers from time to time when corporate actions are announced but the outcome of these actions are highly uncertain. We will resume our coverage once there is sufficient clarity in our view on the impact of the proposed action.

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The analyst(s) who wrote this report and/or her or his respective connected persons held financial interests in the following above-mentioned issuers or companies as at the time of the publication of this report: Singapore Airlines Ltd, GuocoLand Ltd, Oxley Holdings Ltd, Frasers Centrepoint Trust, Suntec Real Estate Investment Trust, Mapletree Commercial Trust, Frasers Hospitality Trust, United Overseas Bank Ltd, CapitaLand Integrated Commercial Trust, AIMS APAC REIT, Lendlease Global Commercial REIT, Ascott Residence Trust.

Co.Reg.no.:193200032W