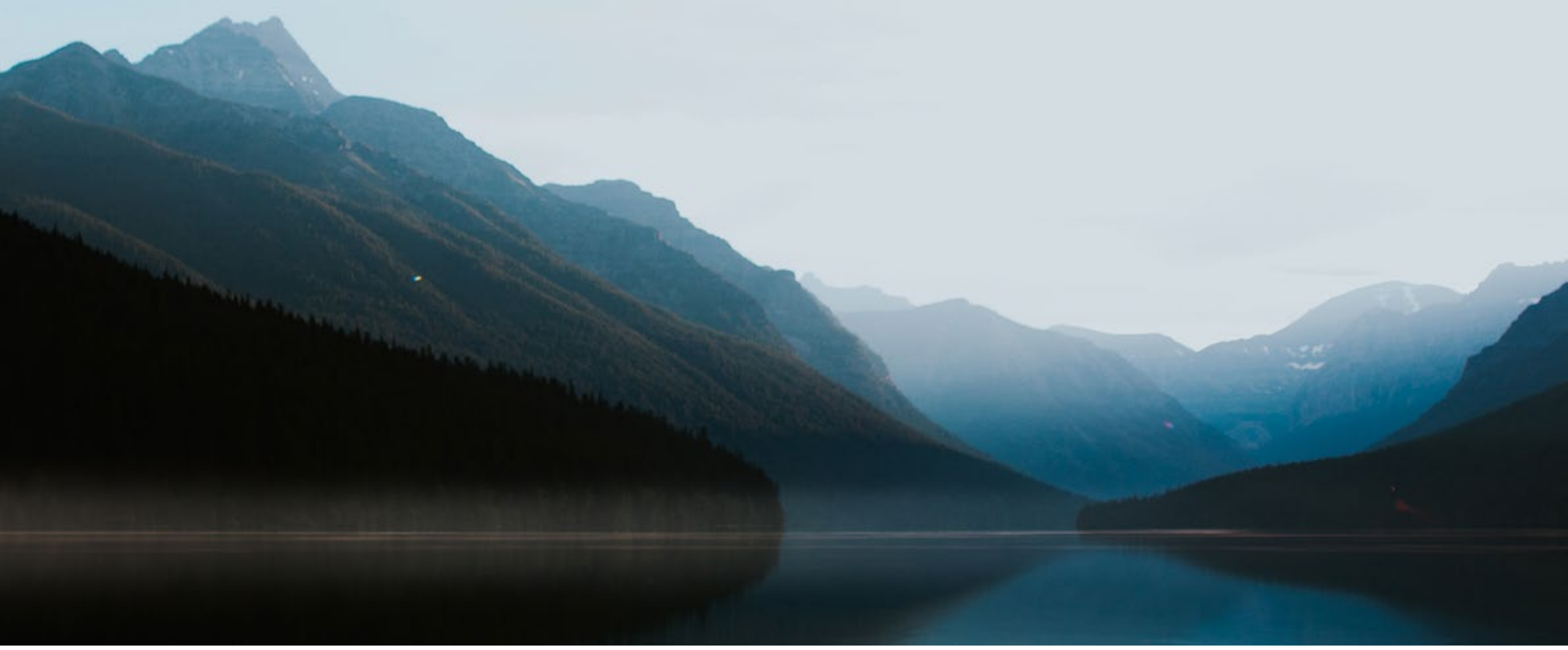
NOVEMBER 2023 UPDATE

Investing for impact

Sustainable finance in New Zealand

Trends & Insights

chapman tripp



Sustainable finance grows upward and outward

Dominant trends in the New Zealand sustainable finance market since our inaugural Investing for Impact publication in May 2022 have been a continued growth in sustainability-linked loans and a significant diversification in lending activity – across borrowers, lenders and scale of lending.

The rise in more tailored and targeted sustainable finance products speaks to the New Zealand market's increasing maturity, the importance of small and medium enterprises (SMEs) to New Zealand's economy, and the role of banks and other lenders in supporting a transition to economic sustainability. We look back on the successes, difficulties and detours of the last 18 months and forward to what the next 18 months may deliver.

Forward trends

We expect the next stage of growth to include:

- **More diversity and innovation.** Sustainable finance has moved from novel to mainstream. We have reached critical mass, so focus can turn from establishing the market to creating products that maximise its benefits and increase participation.
- **A developing emphasis on transparency, comparability and rigour, at home and internationally.**
  - New Zealand's mandatory climate-related reporting regime applies to financial years beginning in 2023 with the first disclosures to be reported in 2024, and
  - The new EU Green Bond (or 'EuGB') standard, based on the EU taxonomy, will take some time even for European investors to absorb but will inevitably filter into global expectations.

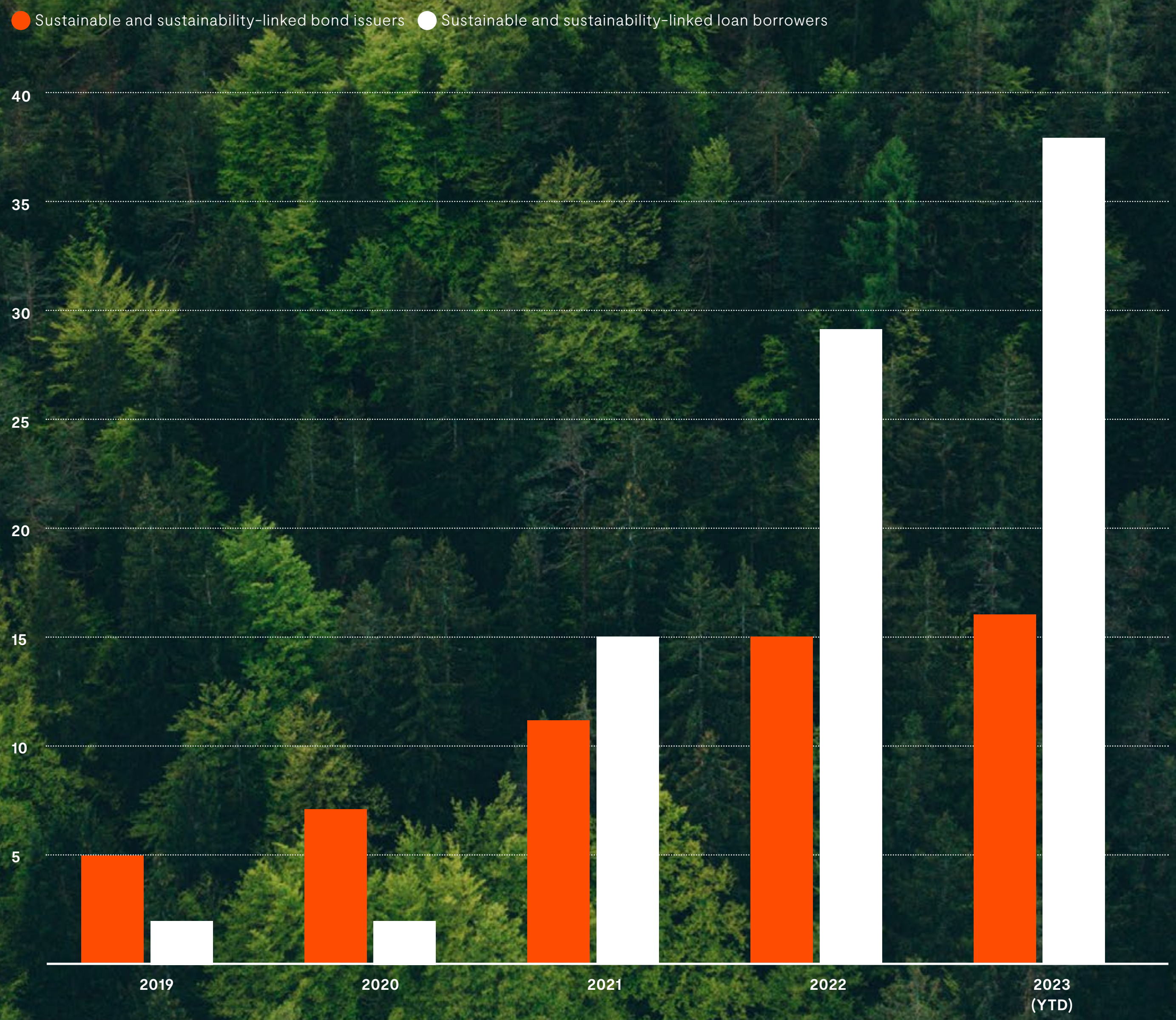
  These sorts of initiatives will continue to proliferate as the climate crisis gathers intensity. Borrowers shouldn't bury their heads in the sand but anticipate the direction of change and try to stay ahead of the curve.
- **Solving regulatory pain points.** The strength of New Zealand's bond markets comes from the engagement and support of both wholesale and retail investors. Work is ongoing to smooth the path for further retail issuance of sustainable bonds.
- **Financial institution issuer participation.** Global green bond issuance by banks increased significantly in 2023, a trend which was mirrored here by a rapid accumulation of eligible assets as New Zealand banks build towards publicly announced sustainable finance targets. There is also space for further participation in the securitisation sector.

Except as otherwise noted, charts and statistics are sourced from public announcements and KangaNews data and are current to 7 November 2023. In some cases, publicly available information may not be complete.

Sustainable finance market by numbers

The sustainable bond market grew significantly over the last 18 months, largely through the addition of a couple of large players. By contrast, the loan market has continued to diversify and is establishing itself as force to be reckoned with.

Number of large New Zealand sustainable issuers and borrowers



This chart captures issuers of outstanding labelled sustainable/sustainability-linked bonds aligned with ICMA principles and/or CBI certified, and publicly announced sustainable/sustainability-linked loans. It also includes the Local Government Funding Agency's sustainability financing bonds and underlying sustainable and climate action loans. It does not include borrowers under general bank customer sustainable finance products.

Sustainable/sustainability-linked bonds

There have been some big moves on this chessboard over the last 18 months. Kāinga Ora – previously the market leader – has been removed from play following a Government decision that it be funded directly but the gap has been more than filled by three new public sector players: the Government itself, the Local Government Funding Agency (LGFA) and Transpower.

We have not seen any new privately owned bond issuers in this period and at times it has felt like treading water, following the rapid influx of new issuers and new developments from 2019 to 2021. The market also continues to grapple with regulatory complexity for retail sustainability-linked bonds.

Spark's issue from March 2022 still has the field to itself and our commentary from that year continues to apply with equal force. We said:

> "Spark's wholesale sustainability-linked bond this year is a sure sign of things to come, but the additional complexity of taking these to retail investors continues to slow supply, showing parallels to our green bond market a few years ago."

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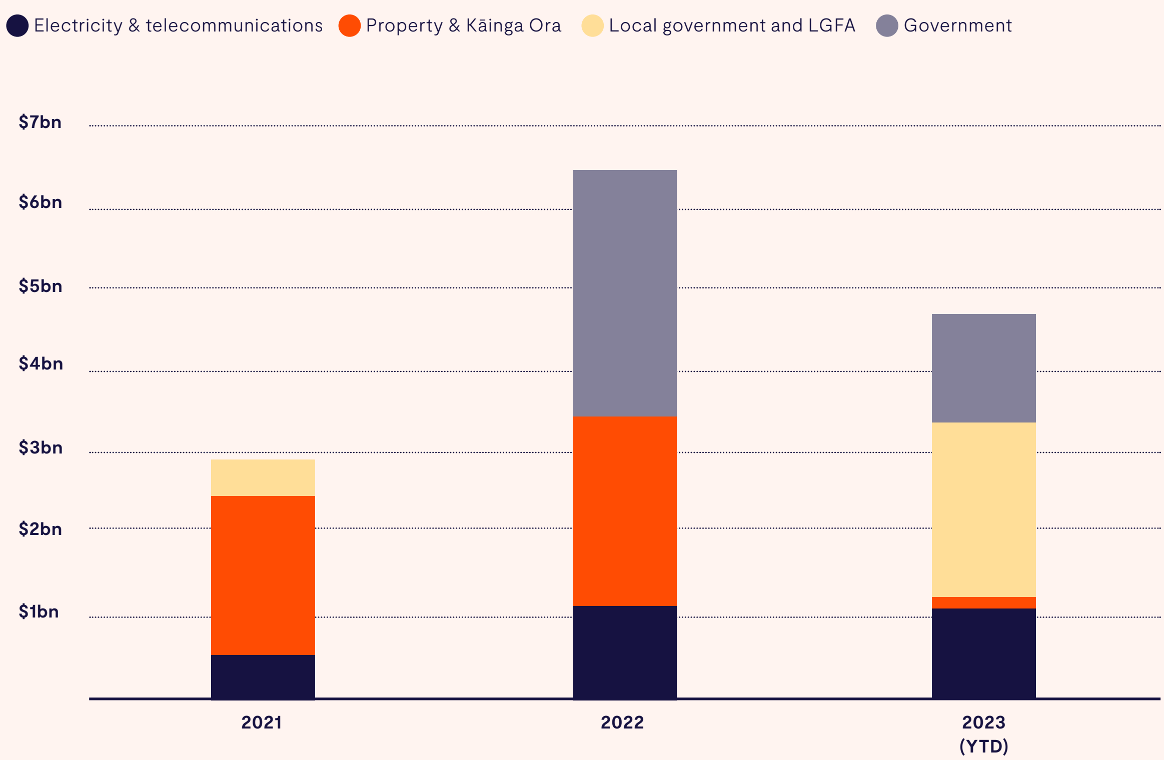


This chart includes syndicated issuances, publicly announced private placements and tender programme issuance by the Crown and LGFA.

However, application of a classic Reasons to Be Cheerful methodology shows that there is more on the positive side of the ledger than the negative.

- New Zealand's ongoing upward trajectory in market size has bucked international trends. Sustainable bond issuance globally shrank 15% in 2022 according to Environmental Finance Data, and recent analysis from S&P Global predicts that 2023 will also be a fairly flat year.
- The Government and the LGFA are New Zealand's two largest borrowers by any measure and between them accounted for around half (40% to 60%) of all sustainable bonds issued in both 2022 and 2023. They, and Transpower as the other new entrant, brought innovation to the New Zealand market – demonstrating that there are growth opportunities beyond established structures:
    - Transpower became the first issuer in the world to align with the Climate Bonds Initiative criteria for Electrical Grids and Storage
    - the Government brought in a dedicated sovereign green bond programme under which it delivered a blockbuster $3 billion issuance in November 2022 (larger by itself than New Zealand's annual issuance of sustainable bonds in any previous year), and
    - the LGFA created a world first in April 2023 with its issue of sustainable financing bonds backed by sustainable and climate action loans to local authorities.
- Much work has been invested to smooth the path for future retail issuances of both sustainable and sustainability-linked bonds. We note in particular, the exemption allowing LGFA to offer sustainable bonds on the basis of a terms sheet (cementing this as a viable option following Christchurch City Holding's initial pathfinder exemption).
- Smaller, targeted social impact bond issuers continue to address specific climate and social issues. Community Finance, for example, has increased its issuance of social impact bonds, adding new reach through traditional distribution channels and clearing systems.
- We expect that financial institutions will dip their toes back in the water, following growth in their sustainable loan asset base.
- More New Zealand issuers have been expanding to offshore markets, including Transpower's green Australian MTN in 2022, joining Mercury NZ as a green bond issuer in that market. Offshore sustainable bond issuances will continue to benefit New Zealand by bringing international experience and rigour home.
- Longer term, we anticipate a key role for sustainable bonds in the funding of New Zealand's infrastructure projects.

Sustainable/sustainability-linked loans

While total new ending volumes have been flat over the last few years, hovering at around $4b annually, the sustainable finance loan market has consistently expanded, propelled by a stream of new borrowers (eight this year alone) and new lenders as the banks expand their product offerings.

Each of the five large banks has created tailored sustainable finance products, focusing on SMEs, agriculture and the general public. This includes:

- ANZ's Good Energy Home Loans & Business Green Loans
- ASB's Better Homes Top Up & Business Sustainability Loans
- BNZ's Green Home Loan Top Up, Agribusiness Sustainability Linked Loans & Green Business Loans, as well as the Quadrent Green Lease
- Kiwibank's Sustainable Energy Loans & Sustainable Business Loans, and
- Westpac NZ's Greater Choices Loan, EV Loan, Sustainable Farm Loan (the first to take a 'whole of farm' approach) & Sustainable Business Loan.

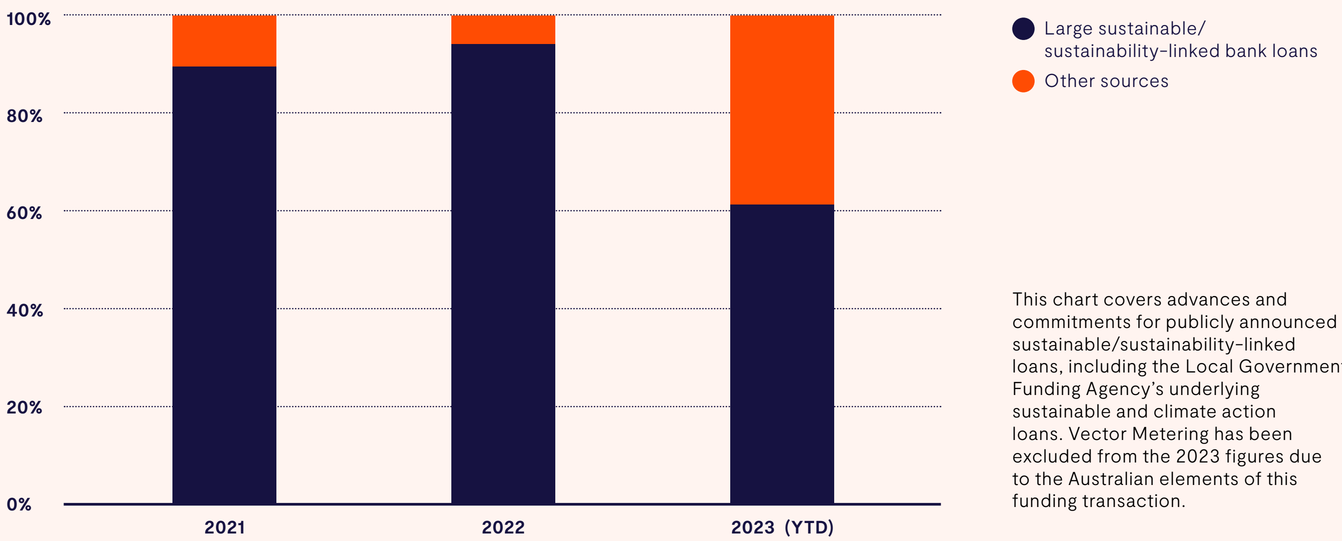
As we said in our 2022 publication:

> "Following 2021's massive increase in uptake, we expect to see banks continue to diversify the number of sectors and borrower types represented in the market. Our economy is highly represented by small and medium enterprises (SMEs), so if banks are to continue the pace they set in 2021, then we expect a focus on making such loans viable on a smaller scale and on a more commoditised basis".

Other lenders have also begun to establish a presence – reflecting the general expansion of private debt, increased financial innovation and regulatory restrictions on bank balance sheets.

These include private capital investors domestic and global; the LGFA, which has become a significant contributor through its sustainable and climate action loans; and other Crown-owned entities like New Zealand Green Investment Finance (NZGIF), which recently arranged $170m of funding, certified by the Climate Bonds Initiative, for solarZero and the NZGIF solar finance programme.

New sustainable/sustainability-linked lending – a diversifying market



This chart covers advances and commitments for publicly announced sustainable/sustainability-linked loans, including the Local Government Funding Agency's underlying sustainable and climate action loans. Vector Metering has been excluded from the 2023 figures due to the Australian elements of this funding transaction.

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