Hong Kong

Green bond market briefing
February 2019

Green bonds from Hong Kong issuers: USD4.9bn overall; USD2.3bn in 2018, or 4.6x 2017 volume
Green bonds arranged and issued in Hong Kong: USD16bn overall; USD11bn in 2018 *
Growth expected particularly from government and non-financial corporates

A burgeoning green bond market underpinned by government's push and incentives

Real estate investment trust Link REIT issued the first green bond from Hong Kong in 2016: a USD500m benchmark-size deal. But it wasn't until 2018 that the market started to pick up speed with private sector companies issuing debut green bonds.

The turning point came when a series of policy signals and measures were announced by the Hong Kong government in late 2017. They aim to promote green finance development by creating liquidity, supporting integrity and providing incentives for green bonds.

In October 2017, the Chief Executive of the Hong Kong government included green finance agenda in the Policy Address, followed by the government's announcement in early 2018 to issue sovereign green bonds. The HKD100bn (USD12.8bn) Hong Kong Government Green Bond Programme is one of the world's largest.

The launch of the Green Finance Certification Scheme, which references international standards, by the government-backed Hong Kong Quality Assurance Agency (HKQAA) and the rolling out of the Green Bond Grant Scheme by the government to help issuers offset the administrative costs of green bond issuance, are also measures that lay the groundwork for robust market growth.

The private sector drove 2018 issuance

MTR, the owner and operator of the metro system, is the largest Hong Kong issuer, with 8 labelled green bonds issued since 2016. In 2017, Hong Kong & China Gas joined the market with two green bonds financing for waste-to-energy projects.

In 2018, there were 9 Hong Kong issuers. They brought USD2.3bn worth of green bonds and green loans to market, 4.6 times higher than 2017 issuance (USD501m). Eight of the issuers are private sector companies, all of which are non-financial corporates. MTR also continued to tap the market with green bonds, but it only accounted for a very small fraction (c.3%) in terms of market share.

MTR is the largest and most frequent green bond issuer with eight green bond deals since 2016, for a total of USD1.1bn. Property entities Link REIT and Swire Properties are also among the top issuers, and both have issued benchmark-sized deal of USD500m.

Green loans became a strong feature in the Hong Kong market in 2018, making up 22% of the annual issuance. Green loans made to Leo Paper Group Finance and New World Development. Both received external reviews from HKQAA.

Allocations to buildings dominate at 37%

In addition to property companies such as Hang Lung Properties, Landsea Green Group and New World Development, MTR - a pioneer of financing public transit through real estate and the value capture model - has also contributed to the green building sector through its

Climate Bonds approach to determining a bond's country

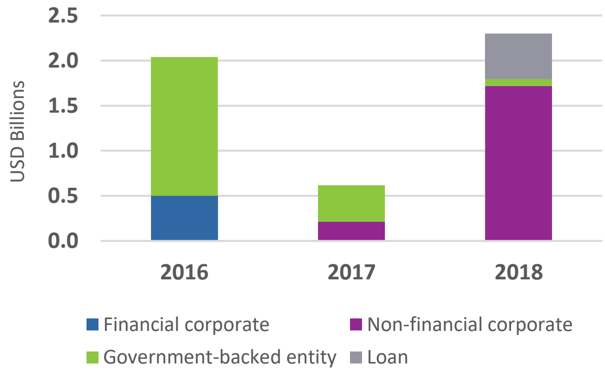
Climate Bonds uses the country of risk to determine how to assign a country to each bond.

For unsecured bonds, the country of risk is determined by the domicile of the issuer. If it is a fully owned subsidiary, then the domicile of the parent or group.

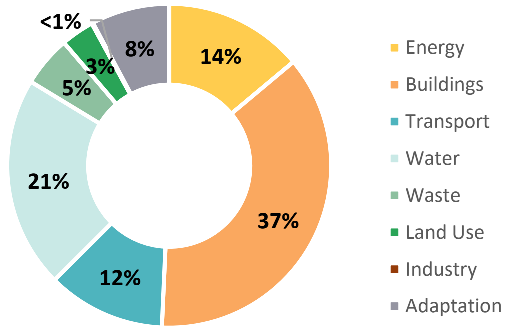
For secured bonds, the country where the assets used as security are located is taken into account and typically drives the decision. However, a parent guarantee or other recourse to a parent company in another domicile would influence the determination.

We do not take denomination currency of the issue, venue of listing or similar factors into account.

Hong Kong issuers have issued USD4.9bn since 2016



37% of proceeds allocated to low-carbon buildings



** Note: HKMA figures capture green bonds, for which a majority of bond arranging activities take place in Hong Kong.* *See p. 3.*

green bond programme. MTR bonds partly finance sustainable transit stations and real estate properties, that have received or expects to receive LEED, BREEAM or other equivalent certifications.

The next largest allocations are to water (21%) and renewable energy (14%). However, the sector mix is diversified and includes low-carbon transport (12%), climate adaptation measures (8%), sustainable waste management (5%) and sustainable land use (3%).

Use of external reviews is prevalent

90% of the bonds by value benefit from at least one external review. Three-quarters have a second party opinion. Sustainalytics is the dominant SPO provider, having reviewed 53% of the bonds by value. SynTao Green Finance (19%) and CICERO (4%) also provide SPOs.

Meanwhile, 27% of the total value of bonds received assurance from HKQAA. Hong Kong issuers have also started obtaining green bond ratings. For example, Landsea Green Group's USD200m deal was rated E1, the highest Green Evaluation Rank by S&P.

Most bonds from HK issuers are in US dollars

USD denominated green bonds account for 55% of issuance. HKD and CNY are also well represented at 17% and 25%, respectively. Notably, all CNY denominated green bonds are green panda bonds and those issued by subsidiaries of Hong Kong domiciled issuers.

Hong Kong domiciled entities have issued four of the five green panda bonds to date, and account for CNY2.9bn (USD430m) of the CNY5.9bn (USD878m) total issuance volume. Green panda bonds are CNY-denominated bonds issued in mainland China by a foreign entity, with proceeds earmarked for green assets.

HKEX is the most popular listing venue

Most green bonds from Hong Kong issuers are listed on the Hong Kong Stock Exchange (HKEX). In mainland China, issuers have listed on the Shanghai Stock Exchange or used the China Interbank Market. Some issuers have listed on international venues such as Frankfurt, Singapore and the Luxembourg Green Exchange.

Beyond green bonds: climate-aligned issuers

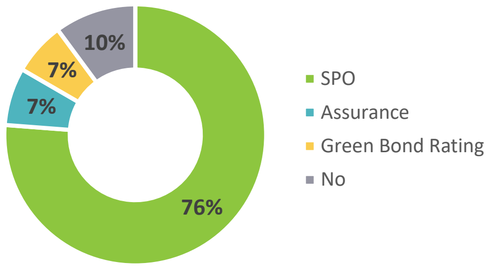
Climate Bonds conducts research into unlabelled bond issuance from climate-aligend issuers, i.e. companies that derive at least 75% of their revenues from green business lines. We identified 13 issuers from Hong Kong, with USD4.3bn outstanding, as of June 2018.

Climate aligned issuers present green bond issuance potential in the transport, energy and water sectors. Green bonds can be used to raise funding for new business investment. Maturing bonds from these issuers also present a green labelling opportunity at refinancing. With significant volumes maturing in 2019, there is an immediate opportunity for labelling the unlabelled climate bonds.

Two strongly aligned climate issuers were identified: MTR and China Dynamitics. MTR is already a green bond issuer, but could pursue explicit green labelling for all its bonds. China Dynamitics, an electric bus company, could benefit from shining a spotlight on its green business to support its growth.

The eleven identified fully-aligned climate issuers account for USD3.7bn of bonds outstanding. Among them are transport sector companies FDG Electric Vehicles, an electric vehicle manufacturer, and Kowloon-Canton Railway, the largest climate-aligned issuer with USD1.2bn of bonds outstanding. China Singyes Solar Technologies, Panda Green Energy and China Water Affairs Group are further examples. GCL New Energy is already a green bond issuer.

90% of issuance has at least one external review

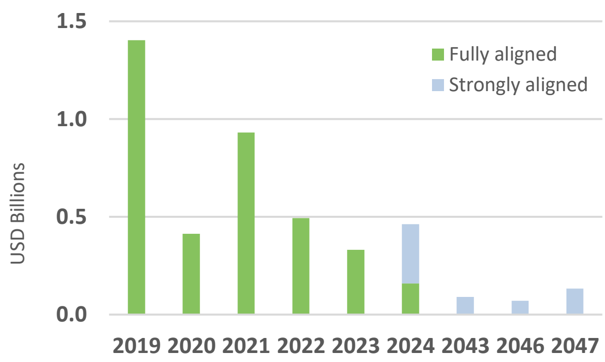


Four green panda bonds have come from HK issuers

Issuer	Amount issued	Year	Sector
Hang Lung Properties	CNY1bn	2018	Buildings
China Power Clean Energy Development Company	CNY800m	2017	Energy
Beijing Enterprises Water	CNY700m	2016	Water
Everbright Water	CNY400m	2018	Water

Note: Beijing Enterprises Clean Energy Group Limited's CNY1bn deal is not included above or the market figure, as its use of proceeds is not aligned with international green definitions.

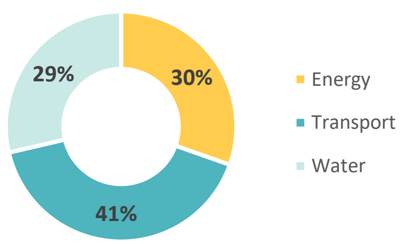
Climate aligned bonds maturing soon may present green labelling opportunities on refinancing



Fully aligned climate issuers are bond issuers that derive >95% of revenues from climate-aligned assets and green business lines such as rail, clean energy, water management, certified forestry.

Strongly aligned climate issuers are bond issuers where 75%-95% of revenues are derived from climate-aligned assets and green business lines.

Climate-aligned issuers operate in three key sectors



Distinction between Climate Bonds and HKMA approach in measuring market size

The Hong Kong green bond market has gained traction throughout 2018. Aside from the green bonds issued by local entities, momentum was also gained in other ways. To reflect the various green bond offerings taking place in this international financial centre, the Hong Kong Monetary Authority (HKMA) adopts a different methodology to Climate Bonds in measuring the green bond market size.

The HKMA considers a green bond as issued in Hong Kong if a majority of its arranging activities take place in Hong Kong. Bond arranging activities comprise originating and structuring, legal and transaction documentation preparation, and sale and distribution. HKMA's approach aims to reflect the size of Hong Kong as a financial centre for green bond issuance.

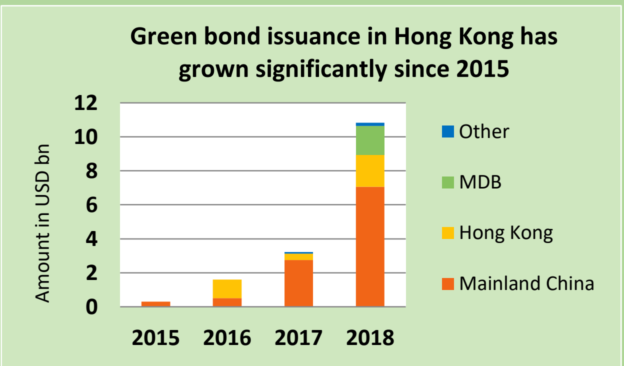
Albeit Climate Bonds and HKMA use different approaches to determine market size, all the green bonds captured by the HKMA are aligned to Climate Bonds green definition. It is also noteworthy that while Climate Bonds includes green panda bonds issued in mainland China by Hong Kong entities in its figures (given the domicile of the issuer), HKMA does not include them in its green bond tally.

Growing green bond issuance in Hong Kong

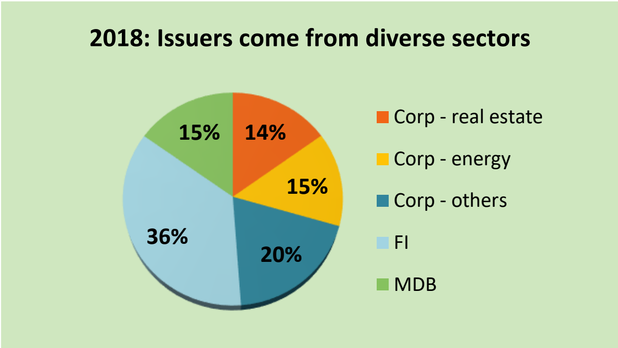
In December 2015, Goldwind New Energy HK Investment brought to Hong Kong its debut green bond, before any Hong Kong entity did. It was the first-ever green bond issued in Hong Kong.

HKMA data shows that in 2018, USD11bn of green bonds were issued in Hong Kong, an increase of 237% from 2017. USD2bn of them, or 17% of the total, were by Hong Kong-based entities. The remaining USD9bn, or 83% of the total, were by non-Hong Kong-based entities. It shows that Hong Kong is an attractive platform accessible to issuers from outside of Hong Kong.

Mainland Chinese entities were the largest issuer group by origin, with an issuance size totalling of USD7bn in 2018, or 64% of the market, with a year-on-year growth of 157%. The popularity of Hong Kong among mainland Chinese issuers is not surprising, given that Hong Kong has traditionally been the offshore fundraising centre of enterprises in mainland China, and has strong investor base and supporting infrastructure.



Source: HKMA, according to HKMA methodology



Source: HKMA, according to HKMA methodology

Diversity of green bond issuers

Real estate companies, energy firms and other corporates contributed almost half of the green bond market size. Financial institutions (FIs) were the second largest issuer type, making up 36% of the total market.

About 81% of FI issuances were by mainland Chinese banks, including Bank of China, Everbright Bank, Industrial Bank and Agricultural Development Bank of China. Most of the rest came from ICBC's Hong Kong-based ICBC Asia.

The rest of the issuances came from multilateral development banks (MDBs), and account for about 15% of the market. Notably, the European Investment Bank issued a USD1.5bn 7-year Climate Awareness Bond in collaboration with the HKMA's Infrastructure Financing Facilitation Office in April 2018. The bond was the largest green bond issued in Hong Kong in the year, and one of the largest USD green bonds in the supranational market globally.

Four key drivers for 2019 issuance and beyond

The Hong Kong green bond market saw encouraging signs of development in 2018. However, it is just a curtain raiser for accelerated green finance in the transition to a low-carbon economy at speed and scale. We anticipate that the following factors will support further market growth and help bolster Hong Kong's position as an Asian green finance hub.

Label the unlabelled

Labelling the bonds of climate aligned issuers green brings visibility to the positive contributions these companies are making towards limiting global warming to 2^{O}C. Issuer commitments to reporting on use of proceeds allocations, and ideally impact metrics, could also strengthen their appeal to the rising number of sustainability-focused investors.

Channel international capital into mainland China

Bond Connect was launched in mid-2017 as a new market access scheme between Hong Kong and mainland China. It provides foreign investors with a much more convenient channel to participate in the onshore bond market through mutual access arrangements in respect of trading, custody and settlement.

Hong Kong entities issuing green panda bond can also avail themselves of the Bond Connect Scheme to engage foreign investors in the onshore bond sale and diversify the green bond investor base. In July 2018, Hong-Kong real estate developer Hang Lung Properties brought to the market the first green panda bond offered through Bond Connect Scheme, and over 50% of the deal was placed with investors from outside China.

Greening of Bond Connect

Climate Bonds has developed a proposition for a Green Bond Connect. It seeks to help Bond Connect investors identify Chinese bonds that meet the international standards of green investment through enhancing information flows. While Bond Connect covers all bonds in mainland China, lack of clarity and transparency of some onshore green bonds can deter foreign investment.

In addition, Hong Kong Stock Exchange could create a dedicated green bond segment displaying internationally-compliant Chinese green bonds. This would enable international investors to easily discover securities which address climate change. The creation of green bond indices and ETFs are also crucial in facilitating capital flows into the green bond space.

Set an example with sovereign green bond issuance

In early 2018, the Hong Kong government announced its intention to issue under a HKD100bn (USD12.8bn) sovereign green bond programme to provide funding for green public works projects. Demonstration issuance would draw investor attention, which would be beneficial to general green bond market growth.

The green bond proceeds will be credited to the Capital Works Reserve Fund. Transparency on the tracking and management of the funds until their full allocation to eligible asset and project financing would provide international investors and society with assurance on the environmental credentials of the government green bonds.

Multi-pronged approach to boost the Hong Kong green bond market

Governments play a pivotal role in kickstarting a green bond market and enhancing market access. In addition to announcing a sovereign green bond program in 2018, the Hong Kong government has deployed further policy tools and supported capacity building.

Certification & disclosure to support market integrity

HKQAA launched a Green Finance Certification Scheme in line with global best practice. In January 2018, HKQAA announced the launch of Green Finance Certification Scheme to provide third-party verification for green debt issuers. The Scheme was developed with reference to international standards on green finance. HKQAA has also become one of Climate Bonds' approved verifiers and eligible to carry out third-party verification and confirm the use of proceeds conforms to the Climate Bonds Standard and Sector Criteria.

Hong Kong SFC unveiled a Strategic Framework for Green Finance. In September 2018, the Hong Kong Securities and Futures Commission (SFC) announced the "Strategic Framework for Green Finance", which emphasises that the SFC would ensure that the green products sold in Hong Kong are credible by providing disclosure guidelines in line with international standards, hence unlocking more diverse green investment opportunities. The SFC will also join forces with the Hong Kong Stock Exchange in exploring the ways to facilitate the listing and trading of green financial products, including bonds, indices and derivatives.

Subsidies to incentivize issuers

Hong Kong government announced a Green Bond Grant Scheme and Pilot Bond Grant Scheme. The Fiscal Budget 2018 revealed government's plan to roll out a Green Bond Grant Scheme, under which green bond issuers using HKQAA's Green Finance Certification Scheme will get up to HKD800,000 subsidy for each issuance. Bonds of HKD500m or more are eligible.

The Pilot Bond Grant Scheme aims to attract more first-time issuers, including from mainland China and Belt & Road Initiative (BRI) countries to issue bonds in Hong Kong. The scheme, which caps at HKD2.5m for each bond, is available to all bond issuers. Green bond issuers can apply for both Schemes simultaneously as long as they fit the eligibility criteria.

Capacity-building to improve market access

HKMA co-hosted events with International Capital Market Association (ICMA), as well as with the Research Bureau of the People's Bank of China (PBoC) and the Hong Kong Green Finance Association to explore Hong Kong green finance opportunities. These high-profile events brought together key policymakers and market experts to discuss green finance policy and market development in mainland China and Hong Kong, and explore how Hong Kong can support and capture opportunities from the national strategy on sustainable development.

The Hong Kong Green Finance Association (HKGFA) was officially launched. It is a concert effort from financial institutions, environmental organisations, service providers and other key stakeholders to position Hong Kong as a leading international green financial centre. Through mobilising private sector resources and talents and assisting the government in the formulation of green finance policies, the HKGFA aims to provide greater access and opportunities for Hong Kong's financial institutions to participate in green financing transactions locally, as well as in mainland China and in BRI markets.

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