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Second opinion on Kommunalbanken Norway (KBN)'s Green Bond framework

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1. Introduction and background

The aim of this second opinion is to carry out an independent assessment of KBN's green bond framework. The broader climate policy context is a situation where nations, cities, local governments ('kommuner'), organizations, companies, and citizens have to move into a sustainable and low climate impact future to avoid significant climate changes and environmental impacts that could imply serious consequences for human living conditions and ecosystems. The new IPCC report released 27th September 2013 emphasized the seriousness of the human-induced climate change challenge and the short time available to level out and then substantially reduce combustion of fossil fuels and CO_2 emissions globally.

A robust and efficient Green Bond framework should be based on a common general framework, where assessment rules and procedures tailored to different applications are consistent with the overall framework, as well as being compact and transparent. For the purpose of building confidence in green bond investments transparency is important, not only in terms of assessment and selection procedures, but also in terms of public availability of information about the projects deemed eligible for green bond funding, the actual investments done, and verification of performance.

2. Brief description of the green bond framework

KBN offers low cost finance to the local government sector of Norway. Investments in green bonds will be transferred to a special account to support KBN's lending to eligible projects (KBN 2013). Eligible projects are defined as project categories that in whole or part promote transition to low-carbon and climate resilient growth, as defined by KBN. Eligible projects include: a) mitigation of climate change, including investments in low-carbon and clean technologies (energy efficiency, renewable energy), b) adaptation to climate change, including investments in climate-resilient growth, and c) projects related to sustainable environment. Table 1 provides examples of eligible project categories.

Eligible projects are selected by the Lending Department of KBN. Such projects must also reflect the environmental policy of local governments. If an eligible project is included in the local government's environmental plan and fulfills the environmental program KBN will subsidize a green lending interest discount. This subsidy is independent of green bonds, which currently are priced in line with benchmark issues. For transparency the investors will receive an annual list of projects financed, more information about some selected project examples, and a summary of KBN's green bond development.

Project category: Climate and low carbon
Renewable energy (solar, wind, wave, hydro)
Bio fuel (from waste)
Energy efficiency
Smart grids
Waste management
District heating
Public transportation
Water management (efficiency)
Sustainable housing (e.g. passive houses)
Climate research and education program
Natural disaster warning system
Project category: Environment
Development of new nature conservation areas
Water cleaning facilities
Harbor cleaning projects

Table 1. Examples of eligible project categories for green bond investments.

3. Assessment of the Green Bond framework

In the following procedures, monitoring and verification, room for subjective assessment, possibility for external effects, rebound effects, and transparency are assessed. Referring to Table 1 attention is limited to the project category climate and low carbon.

3.1 Procedures

Even though the procedure for selecting green bond projects is only briefly outlined in KBN (2013) it is relatively transparent, reasonably simple, and standardized in terms of the roles of different actors and their responsibilities.

3.2 Monitoring and verification

A description of procedures for monitoring and verification of green bond investments is lacking in KBN (2013). However, local governments in Norwegian are by the Planning and Building Act from 2008 required to address climate change at local level, and to outline an energy and climate plan as part of annual budgets. According to 'Kommuneloven' a control committee shall verify that the objectives and intended impacts are achieved ('forvaltningsrevisjon'). This also applies to climate change related projects and investments.

3.3 Room for subjective assessment

As always there is some room for subjective assessment of potential green bond investments. This risk is reduced given the standardized selection procedure. The risk could be further reduced given

involvement of external reviewers, such as from the local government where projects and investments take place.

3.3 Possibility of external effects of projects

Even reasonably "safe" green bond project types may lead to unwanted side effects under certain conditions. The best insurance against negative external effects is a selection procedure delimiting eligible projects to the likely best-performing project categories with respect to climate mitigation or adaptation, or for supporting sustainable development. This requirement is fulfilled in the case of the KBN. However, the concern for external effects also underlines the importance of including procedures for monitoring and verification, which make possible corrective action or termination of the investments in case major problems should occur.

3.5 Rebound effects

Efficiency improvements may lead to rebound effects. When the cost of an activity is reduced there will be incentives to do more of the same activity. From the project categories in Table 1 an example is improved energy efficiency, which in part may lead to more energy use. Another example is public support schemes for renewable energy that increases energy supply, leads to a reduced energy price and thus more energy consumption. Such effects can never be entirely avoided. The recommendation is rather to be aware of such effects and possibly avoid green bond funding in projects where the risk of rebound effects is particularly high.

3.6 Transparency

To build confidence in the green bond investments and KBN's activities in this regard it makes sense to have a broad information strategy that enables information to interested citizens, business, organizations, public agencies, media and politicians. According to KBN's green bond procedure, an overview of green bond projects and more detailed information about selected projects will be publicly available through a KBN web-page. This web-page will be updated on a quarterly basis. Information about green bond activities will also be included in KBN's annual report.

4. Conclusions and possible improvements

The green bond procedure of KBN has many features that enable selection of projects well suited for green bond funding. Transparency is achieved through a publicly available web-page that lists all projects financed and provides more detailed information for a selection of project examples. In terms of verification and performance of green bond related investments, local government are by

law required to specify objectives for i. a. climate change related policies and investments. A control committee is entrusted with the task to verify that anticipated impacts are achieved and objectives met. Thus a general reporting and verification system is implemented at local government level. There may still be some concern, however, whether local control committees have a suitable background to carry out a comprehensive assessment of projects' impacts on greenhouse gas emissions, adaptation to climate change, and sustainable development.

Project category	**Primary objective**	**Likelihood of meeting objective**
Renewable energy (solar, wind, wave, hydro)	Mitigation	Good, but be aware of environmental impacts and possible rebound effects. Care should be taken with large hydro project due to scale of environmental impacts.
Bio fuel (from waste)	Mitigation	Good, but observe complex impacts of some waste types and effects on lifecycle emissions
Energy efficiency	Mitigation	Good, but be aware of possible rebound effects
Smart grids	Mitigation	Medium. Some potential for more efficient power production and consumption. Smart grid technologies fit well with a power system where small-scale renewables have a large share
Waste management	Mitigation	Medium. Good practice waste management should recycle resources and reduce methane emissions
District heating	Mitigation	Medium. Effect on CO_2 emissions depends on energy source. Forest waste and household/business waste are best options.
Public transportation (e.g. electric tram in urban areas)	Mitigation	Good. Potential for emission reduction depends on degree of urbanization, fuel type, and competition with private transportation
Sustainable housing (e.g. passive houses)	Mitigation	Good. Important for long-term sustainable development. Also of importance for mitigation and adaptation to climate change
Climate research and education programs	Mitigation/Adaptation	Good. More knowledge and education on problems and solutions are needed.
Water management (efficiency)	Adaptation	Good. Important given climate change scenarios and higher frequency of extreme weather conditions. Limited effect on mitigation
Natural disaster warning system	Adaptation	Good. Higher frequency of extreme weather events expected from climate change. Improved warning systems and better coordination of roles and actions will reduce impacts and costs of events.

Table 2. Project categories eligible for green bond funding, primary objectives, and likelihood of meeting these objectives.

In terms of eligible project categories, Table 2 illustrates that most of the example project types mentioned are likely well suited for green bond funding.

A useful modification, however, as indicated by Table 2, could be to organize project categories according to the primary objective (i.e. mitigation, adaptation, or sustainable development). For

some of the project categories more care should be taken since the risk of lower efficiency or unwanted side effects is higher, confer Table 2.

In terms of climate research and education programs, KBN has financed the INSPIRIA science center close to Sarpsborg, which offers curriculum related programs to primary and secondary schools, in addition to serving business development and research. This is a good example of strengthening basic understanding of science, that is essential for understanding the climate change challenge and supporting efficient polices to handle this challenge, as well as developing climate-friendly business strategies.

References

KBN (2013), KBN Framework. Draft memo.