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STRUCTURED FINANCE INSIGHT: European Green securitisation volumes unlikely to fulfil investor demand in the short term, but foundations well under way.

Investors last week snapped up **River Green Finance 2020** – Europe's first Green CMBS. The deal, backed by a single French office asset in Paris, complies with ICMA's Green Bond Principles and joins just one other Green securitisation issuer in Europe - Dutch mortgage lender Obvion.

But ESG-conscious investors hoping for more opportunities in the structured finance arena may be disappointed – at least in the short term. The European market has a dearth of eligible assets to support significant Green structured finance issuance and, perhaps more importantly, the definitions of Green securitisations and Green assets are yet to be officially determined.

Agustin Martin Calmarza, head of European credit research at BBVA, does not expect significant flow of Green securitisations in 2020 but, rather, isolated deals. "Commercial mortgages are of larger size and therefore the IT involved in CMBS transactions is easier than Green residential mortgages as collateral," he said. "However we would view the River Green CMBS as a 'one-off'."

Mr. Martin Calmarza said there could be a continuation of the gradual increase in Green covered bonds, particularly in France, Germany and the Nordic region, but he does not foresee significant short-term growth potential for Green RMBS in Europe, which he expects to be limited to specific issuance activity from Dutch or UK names.

Despite dim issuance prospects for 2020, structured finance industry bodies are busy preparing the groundwork for what they hope will be a viable market in the coming years.

"The market for Green securitisation is currently extremely small and will continue to be limited by the amount of eligible assets," said Anna Bak, associate director at AFME. "However, we do expect the market to develop in the coming years. Obvion's Green STORM programme and the recent River Green Finance CMBS show that it is becoming a realistic prospect."

"For this market to develop, it is necessary to have a clear understanding of exactly what is meant by 'Green Securitisation'," she said. "At present there is a lack of clarity on what exactly is meant by the term – for example is it a deal collateralised by green assets, or a deal that uses proceeds to invest in green collateral or projects?"

Market views currently differ as to what should constitute a Green Securitisation, but AFME advocates a conservative approach, specific to securitisations that are collateralised exclusively by Green assets. The River Green CMBS and Green STORM deals have followed this definition.

ICMA's definition of a Green Securitised Bond is broader, however, and defines the bond as being "collateralised by one or more specific Green projects." The definition extends to covered bonds as well as ABS and MBS. AFME believes the definition, which was published some time ago, needs to be redrafted.

"Ideally the securitisation industry could benefit from a defined set of standards for Green Securitisations," said Ms. Bak. "But what would not be helpful is any sort of 'green stamp' for deals, as we do not want to create frameworks within frameworks and divisions within the industry."

Defining Green collateral

While definitions of 'Green securitisation' are being finalised, European Data Warehouse (EDW) is working on initiatives that should increase standardisation and reporting of the green and energy efficient assets that will underlie those securitisations.

"It is necessary to have a clear and standardised definition for 'Green mortgages' across Europe," said Marco Angheben, head of business development and regulatory affairs at EDW. "At present what constitutes a Green mortgage can differ across – or even within – certain jurisdictions. Currently available information, such as Energy Performance Certificates (EPCs), is inconsistent from country to country and therefore presents challenges in the interpretation of the ratings. Specifically two key indicators are energy consumption as well as CO2 emissions, and these vary greatly."

EDW forms part of a consortium of European bodies on the Energy Efficient Mortgage Initiative – funded by the EC's Horizon 2020 Programme – which has two major sub-projects: the Energy Efficiency Mortgages action plan (EEMap), which will create a framework for Energy Efficient Mortgages and tackles the definition of Energy Efficient Mortgages; and the Data Protocol and Portal (EeDaPP), which aims to collect Energy Efficient Mortgages data through a standardised template and make this accessible via a common data portal.

"Data collection and dissemination need to be carefully considered given GDPR provisions," said Eirini Kanoni, Vice president at EDW.

As part of these initiatives, the consortium has proposals for a 'unique identifier' code for buildings across Europe, which would enable users to extract information on buildings' green credentials.

"Once the industry has a clearer set of definitions then we hope that there will be stronger incentives for banks and other financial institutions to lend to green assets," said Mr. Angheben.

Investor demand

Despite all of River Green Finance 2020's Green credentials, the Goldman Sachs-arranged deal was ultimately placed with traditional structured finance investors rather than investors with a specific Green mandate. Nevertheless, some accounts were said to have increased their book sizes on account of the Green collateral and the deal was heavily subscribed across the capital structure.

The final pricing level - well inside IPTs - was deemed to be a reflection of the quality of the asset and the structure compared with other CMBS, but the absolute level was perhaps more a reflection of the current appetite for European SF paper.

In order to classify River Green Finance as a Green CMBS, the deal's issuer put in place a framework entitled the River Green Finance Green Securitised Bond Framework, which set out the basis on which the notes are issued in compliance with ICMA Green Bond Principles. Sustainalytics, an independent global provider of ESG and corporate governance research, provided a second-party opinion confirming as such.

The property received a "Very Good" Building Research Establishment Environmental Assessment Method (BREEAM) certification in January 2017, which was confirmed in January 2019.

Obvion's Green STORM programme has meanwhile issued four deals – one each year since 2016 - and has sought investment from the Green bond community as well as from structured finance investors.

Evidence indicates that the investor base and subscription levels for Green covered bonds are wider and higher respectively than in traditional covered bonds, although there is not yet a clear impact on pricing. The same applies to Green RMBS, noted Mr. Martin Calmaza.

The River Ouest property, referenced in River Green Finance 2020:

Source: River Green Finance 2020 preliminary OC

One-off deals
While River Green Finance 2020 is unlikely to herald a new Green dawn for the European structured finance market, one-off deals with Green credentials are not out of the question for the coming year, either.

This week, for example, NatWest securitised a £1.1bn portfolio of sustainable project finance loans. This was said to be the first exclusively UK ESG synthetic securitisation from a UK financial institution and provides credit protection against a reference portfolio of sustainable energy project finance loans. Macquarie Infrastructure Debt Investment Solutions, working in conjunction with BAE Systems Pension Funds Investment Management, invested in the deal.

"We expect Green securitisation to pick up in Europe, particularly in light of the EC's regulatory push to support sustainable finance," said Gordon Kerr, senior vice president, head of European research, DBRS Morningstar. "In the long run we see securitisation as an excellent vehicle for Green finance, particularly in light of the bonds having a transparent, fixed pool of Green assets."

"Given investor demand for Green assets, it is a sector to watch – if not in 2020, then in 2021," concluded Mr. Angheben.