Trends and opportunities in impact credit

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The fast-growing market for impact credit offers investors a rich source of opportunity and diversification. Nuveen portfolio managers Stephen Liberatore, CFA® and Jessica Zarzycki, CFA® discuss the trends and opportunities, from global issuance and innovative transactions to defining impact and balancing competing objectives.

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Q: What issuance trends are you seeing in the sustainable bond market versus the broad bond market?

SL: We're likely to eclipse $1 trillion dollars of issuance this year for bonds labelled green, social and sustainable (GSS). The market will have over $5 trillion of historical issuance, and over $4 trillion of market value outstanding. While GSS labels aren't how we define impact at Nuveen, it's a very good proxy for the market growth.

That $5 trillion in issuance shows the maturation of the market. And it also allows us to position portfolios to perform, regardless of the market environment, in a broadly diversified way.

We see impact opportunities not just in corporates, but across most bond market sectors, including sovereigns, supranationals, asset-backed securities, residential and commercial mortgage-backed securities, municipals, agencies, emerging markets and high yield.

Q: Are there regional differences?

JZ: Europe is the largest player when it comes to GSS issuance, representing roughly 50% of the labelled market. Some of this higher volume is attributable to government issuance, notably green bonds from Italy, France and Germany.

Issuance across Asia is growing, with Australia issuing its first green bond in June this year. But China remains the largest issuer in the region, followed by Korea and Japan.

Today, we see a growing number of emerging market sovereigns and corporates issuing GSS bonds. With the acute need to drive capital to lower-income economies, the GSS market offers a way to increase the investor base.

Q: Where are you seeing the most compelling developments in terms of different financing trends, such as blended finance, debt-for-nature swaps and sustainability-linked bonds?

SL: We're going to see more innovation in this area, and blended finance is likely to be at the forefront of that. Blended finance is using public-private partnerships to create transactions that have some type of de-risking mechanism to make them more attractive to investors.

We've participated in some recent innovative transactions, in which very clear use of proceeds have enabled us to drill down into exactly what the transactions will finance. Some have blended finance components. Some don't. When we engage with issuers and underwriters to help structure a transaction, we are guided by our focus on use of proceeds and transparent, outcomes-based reporting. Our goal is to determine exactly how our client's capital is going to be used and how we can measure the results.

JZ: A benefit of blended finance transactions is also getting access to experts. We speak with the scientists, project managers and government officials to understand not only the environmental impact, but also the economic and social impact. It allows us to learn more about specific topics and disciplines that most asset managers don't maintain expertise in, for example, rhino biology, marine area biodiversity and the science behind carbon reduction versus removal credits.

We're always learning and building our skill sets as we look at new environmental and social projects —how they impact corporations; how they impact governments; and how do we make it better going forward. We want to continue to build out the space so that we're moving from that $1 trillion mark of issuance to $1.5 trillion, to $2 trillion. And then collectively the market can start to meet more of those large-scale sustainable objectives.

Q: How does Nuveen define impact investing in fixed income?

SL: For us, an impact investment has to have a direct and measurable social and/or environmental outcome associated with it. Direct refers to the bond's use of proceeds, and measurable relates to the transparency and relevance of outcome-based impact reporting. But critically, we are investors looking to generate excess return over time; we aren't making grants or deploying concessionary capital. So when we look at a transaction, even if it could be the most impactful transaction we've ever seen, we're not investing if it doesn't have an attractive total return profile.

Q: Tell us about some of the transactions in which Nuveen has been a lead investor. What's the benefit to our clients?

SL: We've been the lead investor in some unique transactions — the Vietnam emissions reduction bond that provided clean water to rural school students in Vietnam; the Ecuador debt-for-nature swap that funded marine conservation of the Galapagos Islands; the wildlife conservation bond which funded protections and breeding programs for the endangered black rhino population in South Africa; a reforestation bond that provides capital to acquire previously deforested parts of the Amazon, which is the first public fixed income market transaction to remove carbon from the environment.

Being a leader in this space, we're often contacted prior to these deals becoming more widely known. We can express our views on what we would need to see in a transaction for us to participate.

Getting involved in the structuring allows us to represent our investors. We're able to obtain the most optimal structure, the appropriate data and reporting, and access to relevant experts so that we have the best possible understanding and knowledge of what is occurring.

JZ: The power of no can be just as important. We've said no to transactions that did not meet our direct and measurable impact framework. And we then saw subsequent deals with tighter, better structures as a result.

Learn more about fixed income impact investing at Nuveen.com

Data sourced from Sustainable Bonds Insights 2024, Environmental Finance.

Responsible investing incorporates Environmental Social Governance (ESG) factors that may affect exposure to issuers, sectors, industries, limiting the type and number of investment opportunities available, which could result in excluding investments that perform well.
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