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Jessica Zarzycki
portfolio manager,
global fixed income
Nuveen

As the world grapples with pressing social and environmental challenges, the role of impact investing has gained significant traction. Equities used to be the go-to channel for many investors but in recent years, the attention has shifted to fixed income.

For example, even as bond issuance went backwards last year, the sub-segment of sustainable bonds fared better. Reflecting its investment appeal, the sustainable bond market's share of the global bond market grew 13.5% last year, up from 7% in 2020.

Nuveen is one of the leading players in this field and had poured more than 15 years into molding and refining its strategy. In this edition, the fund manager explains what will drive the investment performance of so-called green, social and sustainable bonds and where it finds the best value.

Michelle Baltazar
Michelle Baltazar
Director of Media & Publishing

Making an impact with fixed income

Impact investing is an increasingly compelling consideration for core bond allocations.

The market for publicly traded bonds that provide intentional, direct and measurable social and/or environmental impact has evolved significantly.

Over the past 10 years, the impact bond market has grown rapidly to approach or even exceed the size of many established bond markets. The breadth of issuers has multiplied substantially, the range of tenors increased, and the uses of capital have broadened across social and/or environmental concerns.

Market rapid growth over the last decade

Estimating the size of the impact bond market is a challenge. Market participants have yet to coalesce around a consensus definition of an impact security. Data providers, however, have generally come to agree on GSS as an acceptable acronym for this market: green, social and sustainable bonds.

Issuance of GSS-labelled bonds exceeded $1 trillion for the first time in 2021 and nearly doubled in 2020 and 2021, according to Environmental Finance's Sustainability Bond Insights 2023. And while 2022 was a challenging year for bond markets generally, and GSS bond issuance declined, the underlying trends for 2022 signal the ongoing maturation of this market. Issuance declined 26% across fixed income markets, yet green-labelled bonds experienced a significantly lower fall of 10%. The sustainable bond market's share of the outstanding global bond market rose to 13.5%, an increase from 12% in 2021 and 7% on 2020[1].

Broadening of market creates more access to impact capital

A decade ago, issuance overwhelmingly came from large corporations in developed markets and multinational organisations with missions to support developing markets. Today, smaller companies, organisations, agencies, municipalities and sovereigns from across developed and emerging markets are active issuers. In addition, a wide variety of structured securities including mortgage-backed, commercial mortgage-backed and asset-backed securities have also tapped this growing market. The greater breadth of issuers has expanded diversity in tenors too.

Use of proceeds: So much more than green bonds now

The impact bond market was initially focused on financing renewable energy projects, but over the last decade has expanded across a myriad of social, community, sustainable and climate-aligned themes and outcomes.

Recent developments include blue bonds that focus on ocean preservation and restoration, and orange bonds that raise funds to support initiatives related to gender equality. Social impact investment broadly has grown with areas such as racial justice and even vocational training generating significant interest and activity. COVID-19 relief bonds funded the manufacturing of personal protective equipment, increased staffing at hospitals, expanded access to vaccinations and other health services, and, in some countries, unemployment benefits for workers displaced by COVID shutdowns. In 2022, the World Bank issued the first-ever Wildlife Conservation Bond — dubbed the Rhino Bond given the endangered animal population the proceeds will support.

Improvements in reporting and the development of frameworks and regulations across the industry have also helped investors allocate capital and track the real-world results of their investments with more precision.

Today, there are ample opportunities for investors seeking compelling risk-adjusted absolute and relative returns while financing initiatives that are driving positive environmental and/or social outcomes. At Nuveen, we have been refining our impact bond framework for more than 15 years with a focus on transparency and disclosure. We have identified several best practices for investors focused on expanding their exposure to impact bonds.

1. Start with intentionality

Identify the specific causes or areas of social and/or environmental impact your institution wants to focus its efforts on. In developing our fixed income impact framework at Nuveen, we engaged our clients in discussions and evaluated the opportunities across bond market sectors. We then decided to direct impact capital across four themes: affordable housing, community and economic development, renewable energy and climate change, and natural resources.

The quote

As investors increasingly recognize that they have access to impactful investment strategies — without having to sacrifice performance, liquidity or security — they further increase the supply of capital for financing ever more innovative projects.

Watch the video on www.fsitv.com

2. Make impact direct and measurable

An institution needs to provide clarity on how it will deliver on its impact intentions. At Nuveen, we use the following guidelines for impact bonds:

- **Direct:** The capital raised must fund specific projects or initiatives that deliver a clearly defined environmental and/or social benefit, including pure-play issuers; typically, general purpose debt does not meet this standard.
- **Measurable:** The issuer must be able and willing to disclose key performance indicators through impact reporting for the project or initiative. Such disclosure enables investors to assess efficacy on a financial and outcome basis.

3. Prioritise engagement with issuers

Engagement with issuers is an essential aspect of Nuveen's approach to responsible investing broadly and impact investing particularly. As one of the world's largest fixed income managers, we maintain strong relationships with issuers, underwriters, policy makers, ratings agencies and asset owners. We use these relationships to engage in ongoing dialogues about how to structure bonds, what characteristics are needed to satisfy investor demand and the appropriate level and quality of impact disclosure and reporting.

Today, Nuveen has deployed over $10 billion[2] in strategies that deliver measurable social and environmental benefits to people, communities, and the planet. We invite you to explore some of these capabilities and investment opportunities. FS

1. Data sourced from Environmental Finance's Sustainability Bond Insights 2023
2. As of 3 October 2022