Europe ESG corporate bonds: pick-up expected in 2024

Investor appetite for ESG corporate bonds cooled in 2023, and issuance from European utilities and real estate companies declined sharply. But we expect a moderate pick-up in overall volumes in 2024.

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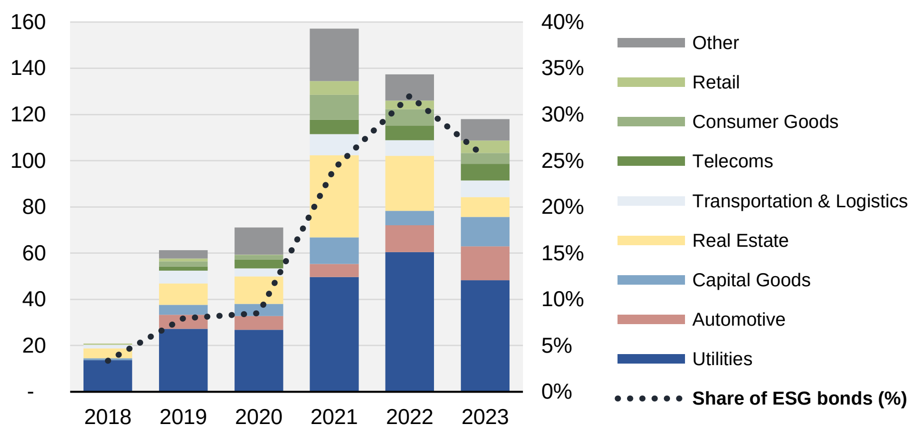
The volume of new European ESG-linked international corporate bond issuance (excluding taps) rose by almost 25% in January 2024 y-o-y to USD 24bn-equivalent[1]. But ESG-linked flows were not able to keep up with the rampant supply propelled by the rally in yields and spreads. European corporate issuance volumes overall rose by 47% in January 2024 so the proportion of ESG-linked bonds fell to 35% from 43% in January 2023.

For 2024, we expect a moderate increase in the volume of ESG-linked bonds, based on a mild recovery in volumes in the real estate sector from the lows in 2023 driven by increasing refinancing needs. The market consensus on potential interest-rate cuts for 2024 may provide further support for overall bond volumes in the second half.

In 2023, corporate ESG-linked bond issuance declined by around 15% to approximately EUR 120bn whereas overall bond issuance increased by 7%. European ESG-linked corporate bonds accounted for 25% of all European non-financial corporate bonds issued compared to 32% in 2022. But while the proportion of ESG-related bonds in Europe fell 7pp, activity was still significantly above the 4% in both North America and Asia. Europe's leadership in ESG bonds looks unbeatable for now.

Figure 1: European ESG corporate bonds by volume (EUR bn) and sector per share of total issuance (%)



Source: Bloomberg, Scope Ratings

[1] Bond Radar data

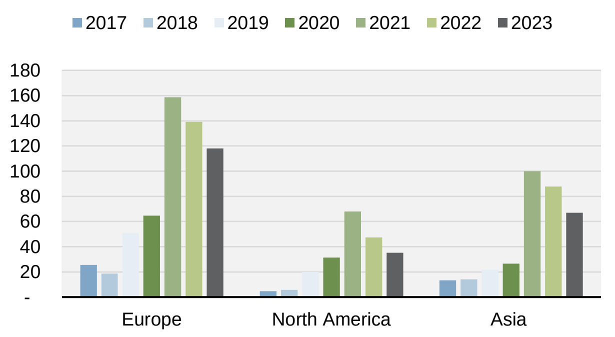
European corporate treasurers cooling on ESG-linked bonds

Corporate ESG-linked bond issuance in Europe fell by around 15% in 2023, compared to 2022, despite a 7% volume increase in the overall corporate bond market. Key drivers were the collapse in real estate issuance – the sector has been a heavy issuer of ESG-labelled bonds – and the decline in sustainability-linked bonds.

On the investor side, greenwashing concerns led to lower demand for ESG bonds in 2023, but diminished yield advantages did as well. Greenwashing concerns, especially for sustainability-linked bonds (see page 3), also led to the disappearance of a significant greenium.

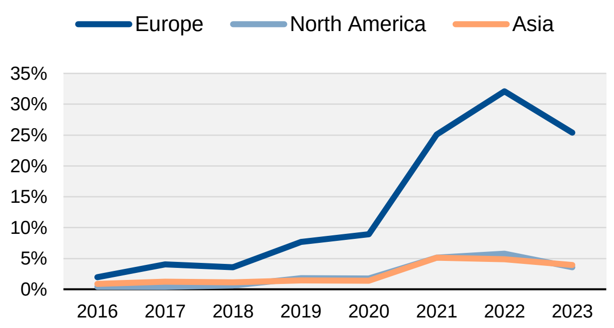
An October 2023[2] ESMA study showed no statistical significance to differences between ESG and conventional bond pricing (i.e. greenium) in 2023, as the market has matured. ESG bond issuers have clearly benefited from yield discounts in previous years. However, this is not necessarily a long-term feature: progress towards a more standardised and transparent framework and enhanced credibility towards issuer's commitments to sustainability could revive pricing advantages to conventional bonds.

Figure 2: ESG-linked non-financial corporate bond issuance by region (EUR bn)



Source: Bloomberg, Scope Ratings

Figure 3: ESG-linked bonds as a proportion of non-financial corporate bond issuance by region (%)



Source: Bloomberg, Scope Ratings

Leading ESG-linked bonds European issuers in 2023 included ENGIE SA (EUR 6.0bn), Volkswagen AG (EUR 5.7bn), Eni SpA (EUR 3.8bn), Energias de Portugal SA (EUR 3.1bn) and Telefónica SA (EUR 2.6bn). In January 2024, active issuers included Volkswagen AG (USD 3.7bn-equivalent) Enel SpA and Telefonica SA (both EUR 1.75bn), E.ON SE and Eurogrid GmbH (both EUR 1.5bn) and Energias de Portugal SA (EUR 1bn).

Green bonds holding their ground in Europe

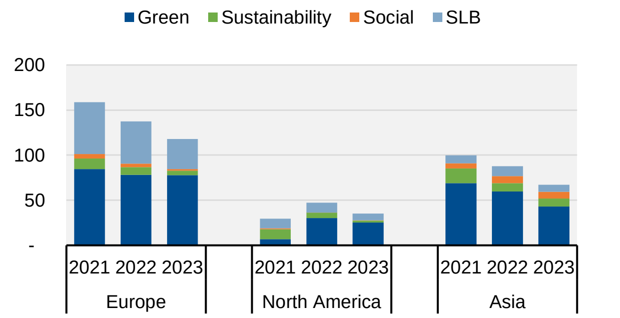
Proportion of green bonds in Europe rises as other ESG types decline

Among ESG-related bond segments, green bond issuance was stable in 2023 while all other types fell, especially sustainability-linked bonds. This can be partly explained by policies in several countries that have created incentives for corporate green bonds, which accounted for around two-thirds of ESG-related bonds in 2023. This is broadly in line with issuance in North America and Asia, which both showed the proportion of green bonds in total non-financial corporate ESG-linked bond issuance ranging between 65%-70% in 2023. In absolute terms, issuance of green bonds in Europe remained stable at EUR 80bn.

[2] https://www.esma.europa.eu/press-news/esma-news/esma-provides-analysis-issuers-potential-benefits-esg-pricing-effect

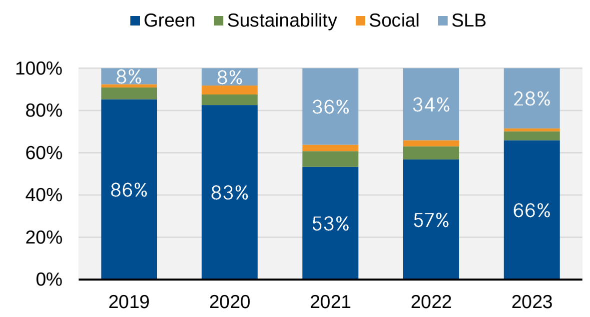
Green bonds benefit from a favourable regulatory framework while efforts to standardise and enhance transparency in the green bond market are increasing, not only in Europe (where the EU green bond standard was published in November 2023) but elsewhere. China's common ground taxonomy announced in July 2023 aims to align with global standards. This trend should play a favourable role in growing green bonds and reducing the risk of greenwashing.

Figure 4: ESG corporate bonds by region and type (EUR bn)



Green, sustainability and social bonds are use-of-proceeds instruments financing specific ESG projects. SLBs are general corporate purpose bonds where coupons are linked to key performance indicators tracking sustainability performance targets
Source: Bloomberg, Scope Ratings

Figure 5: European ESG corporate bonds by type (%)



Source: Bloomberg, Scope Ratings

Declining proportion of sustainability-linked bonds in Europe (and worldwide)

After an impressive increase in Europe in 2021, the proportion of sustainability-linked bonds (SLBs) has progressively decreased, from 36% in 2021 to 28% in 2023. In absolute terms, issuance of SLBs fell by almost 30% from EUR 47bn in 2022 to EUR 34bn in 2023. A similar downtrend was observed in North America and Asia.

As mentioned above, SLBs have come under increasing scrutiny for increasing the risk of greenwashing. Several factors have alerted investors in previous years, including the subjective choice of ESG targets (both in terms of magnitude of improvement and selection of the ESG factors to improve) and the fact that the coupon step-up is often perceived as too feeble to deter companies from missing ESG targets. According to a BloombergNEF report of November 2023, issuers of SLBs are "off-track" for 43% of the KPIs they selected to target, notably increasing the risk of a material portion of borrowers missing their targets.

Since meeting ESG targets in SLBs is tied to a specific future date, by setting the timing of ESG targets close to the maturity of the bonds, SLBs may be less useful in monitoring interim ESG performance. Therefore, it can raise the risk of greenwashing.

Also, exercising call options ahead of coupon step-ups – as some issuers have done – is another sign of potential greenwashing associated with these instruments. From the issuer side, we see a progressive loss of convenience in issuing SLBs, since the diminishing greenium or the lack of any greenium compared to previous years does not compensate for the reputational risk and potential penalties to be paid to bondholders if ESG targets are not met.

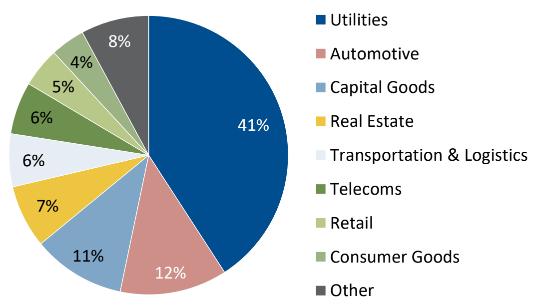
Real estate ESG issuance fell significantly amid sector downturn

Utilities, automotive and capital goods issuers covered over 60% of ESG bonds in Europe

ESG-linked corporate bond issuance in Europe in 2023 was led by the utilities sector as usual, with around 40% of the total. Capital-intensive sectors like automotive and capital goods saw notable increases in the weight of ESG bonds issued but real estate lost significant ground. These four sectors covered a combined 71% share of the ESG-linked bond market in 2023.

Figure 6: Sector split in 2023

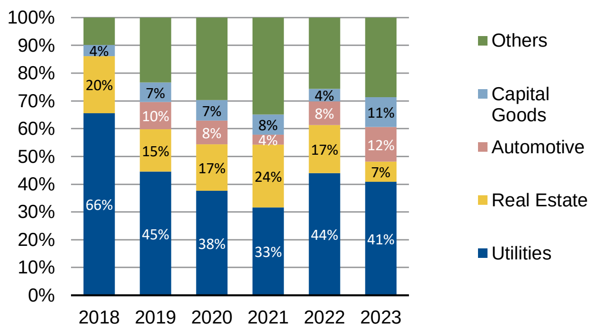
ESG-linked European corporate bonds split by sector in 2023



Source: Bloomberg, Scope Ratings

Figure 7: Sector split over time

Weight of key sectors in terms of share ESG bonds over time



Source: Bloomberg, Scope Ratings

Utilities still leading the ESG bonds volumes but down in 2023

Utilities have historically been the most active issuers of ESG-linked bonds in terms of both amount issued and number of issues. ESG-linked bond issuance volumes from utilities suffered in 2023, despite the sector's central role in the energy transition and the heavy capital expenditure required. ESG bonds accounted for 49% of the volume of total bond issuance from the sector down from more than 60% for the past two years.

This was partly driven by a decline in ESG-linked issuance from major issuers such as ENEL in Italy (EUR 1.5bn new ESG bonds in 2023 vs. EUR 11bn in 2022) and TenneT in the Netherlands (no new issuance in 2023 vs. almost EUR 7bn in 2022). Nevertheless, the sector still accounted for 40% of total European ESG-linked corporate new issues in 2023. Green bonds were the main contributor.

Real estate bond issuance crashed in 2023 amid higher interest rates and risk premiums

ESG bonds from real estate issuers have historically seen the second largest volumes after utilities. But European ESG bond issuance from the sector collapsed in 2023, falling by more than 60% to EUR 8.6bn (international bonds plus domestic bonds in NOK, SEK and other currencies), whereas total issuance of European real estate bonds rose by 8%. The decline was particularly evident in Germany, where not one new ESG real estate bond was issued last year.

But based on a mild recovery in volumes in the second half of last year and into January 2024, we predict this could continue for the remainder of this year. Scope sees a 40% increase in bond refinancing needs by the European real estate sector in 2024-26[3], which will contribute to a recovery in ESG-linked bond volumes from the lows of 2023.

ESG-linked bonds made up 44% of total bond issuance from real estate companies (down from 52% a year earlier), making it the sector with the second highest ESG share. Therefore, even a mild recovery in real estate issuance in 2024 could benefit the share of overall ESG bonds in Europe.

[3] https://www.scoperatings.com/ratings-and-research/research/EN/175388

The automotive sector experienced the most notable increase in ESG-linked debt issuance, overtaking real estate to become the second largest sector in 2023 in absolute terms. The sector has seen a recovery since 2022, which has been accompanied by a relative increase in bond issuance. ESG-linked bond issues made up 27% of total automotive bond new issues by volume and 12% by number of bonds.

Automotive saw the highest increase in ESG bond volumes in 2023

Figure 8: Share of European ESG-linked non-financial corporate bond by sector

Share of ESG bonds	2018	2019	2020	2021	2022	2023
Utilities	19%	37%	32%	62%	66%	49%
Real Estate	7%	11%	18%	37%	52%	44%
Capital Goods	1%	5%	5%	18%	14%	22%
Consumer Goods	0%	5%	3%	16%	13%	8%
Transportation & Logistics	4%	10%	4%	15%	25%	22%
Healthcare	0%	1%	6%	16%	8%	8%
Telecoms	0%	2%	5%	17%	35%	29%
Retail	2%	6%	1%	20%	22%	25%
Automotive	0%	7%	9%	13%	27%	27%
Chemicals	0%	5%	4%	17%	26%	1%
Oil & Gas	0%	1%	1%	9%	4%	26%
Basic Resources	0%	2%	20%	10%	18%	15%
Technology & Media	0%	0%	0%	4%	7%	0%
Leisure	0%	0%	0%	0%	0%	0%
Other				15%	0%	0%
Share of ESG bonds (%)	**3%**	**8%**	**9%**	**24%**	**32%**	**25%**

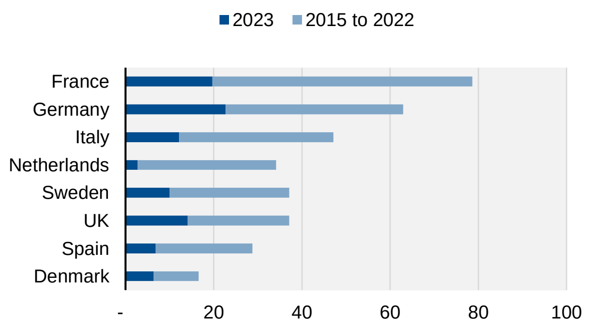
Source: Bloomberg, Scope Ratings

German and French corporates dominate ESG bond volumes in Europe

ESG-linked bond issuance in 2023 was diverse by country. German corporates took the lead with more than EUR 20bn. French companies still have the largest cumulative amount of ESG bonds issued since 2015 with close to EUR 80bn, followed by German companies with more than EUR 60bn. Utility ENGIE was the largest issuer in 2023 with around EUR 6bn, followed closely by Volkswagen. Germany and France both had an ESG share of around 25%. Scandinavian countries have the highest share of ESG-linked issuance relative to total corporate issuance, owing to their mix of utilities and real estate issuers. The story in Italy is similar.

Large issuance of ESG-linked bonds by German and French companies

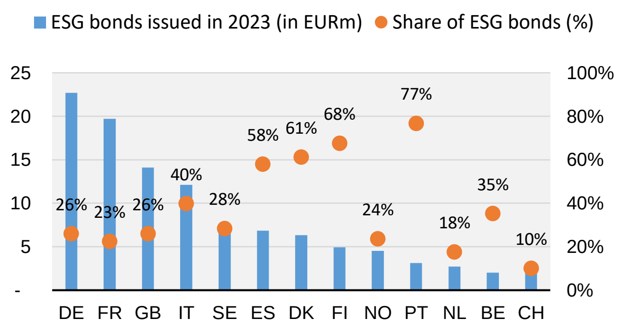
Figure 9: Cumulative ESG-linked bonds by geography since 2015 (EUR bn)



Source: Bloomberg, Scope Ratings

Figure 10: New ESG-linked bonds by geography in 2023

Utilities and Real Estate share within ESG European corporate bonds



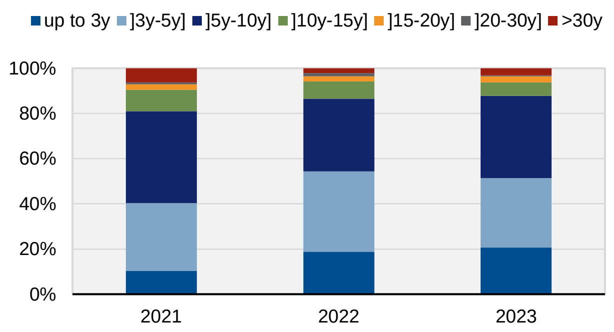
Source: Bloomberg, Scope Ratings

ESG-linked bonds clustered around short to medium-term maturities

ESG-linked bonds with five-year maturities were the most common in 2023, contributing a quarter of total ESG-linked bond issuance. ESG bonds with maturities up to 10 years accounted for almost 90%, while maturities of up to five years accounted for around half the total. The maturity profile reflects alignment of the bonds with the underlying projects they finance, especially for green bonds.

ESG bonds with five-year maturity are the most common

Figure 11: Maturity of European corporate ESG bonds (%)



Source: Bloomberg, Scope Ratings

Figure 12: KPIs targeted by ESG bonds

Percentage of KPIs selected by ESG bond issuers

KPIs	2022	2023
Greenhouse gas emissions	71%	82%
ESG Score	17%	10%
Circular economy	12%	6%
Renewable energy	11%	3%
Affordable housing	3%	7%
Water consumption	7%	1%
Gender equality	5%	3%
Transport	2%	4%
Sustainable sourcing	2%	3%
Energy efficiency	2%	1%
Labor	3%	0%
Education	1%	0%
Other	15%	14%
Share of ESG bonds with KPIs	25%	18%

Source: Bloomberg, Scope Ratings

Expanded use of greenhouse gas emissions as KPI

Only 18% of ESG-linked bonds by number of issues reported KPIs in 2023 versus 25% in 2022. GHG emissions remain by far the primary KPI, present in over 80% of bonds, increasing their weight compared to 2022. This comes as no surprise as GHG indicators are relevant for most industries. But they also have a direct link with the EU's goal of reaching climate-neutrality by 2050. Overall, KPIs depend on sector factors. For example, in 2023, there were fewer circular economy and renewable energy KPIs, which is related to the lower portion of bonds issued by chemicals companies and utilities.

Greenhouse gas emission present 82% of times as KPI in 2023

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(February 2023)

Europe's ESG-linked bond issuance plateauing at 30% of total corporate issuances
(July 2022)

Europe's social-, sustainability-linked corporate bond issuance surges as issuer base widens
(January 2022)

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