°CICERO Shades of Green

Continuum Green Energy

Addendum: Second Opinion on Green Bond Hedge

February 25, 2021

Continuum Green Energy's ("Continuum") has established a Green Hedge Framework to support the implementation of its Green Bond Framework by hedging ("green hedge") against the currency risk related to green bond projects. The costs of the green hedge tied to the green projects eligible under the green bond framework could be financed by green bond proceeds. Continuum plans to use green bond project cashflows to finance the costs of the hedge and the issuer commits to tie the total hedged amount to the green bond issuance. According to Continuum, the company has committed to hedging currency risks for interest and principal payments related to green bonds in its offering memorandum. The exchange risk results from revenue from projects being in Indian Rupees and interest and principal payments in US Dollar.

Background: Green Bond Framework

Continuum Green Energy ("Continuum") is a renewable energy group based in India, focusing on large-scale wind farms which can be co-located with solar photovoltaic (PV) installations. Continuum was founded in 2009 and currently has a total portfolio of 2.0 GW, with an operating capacity of 757.4 MW across six renewable projects in five states in India.

CICERO Shades of Green has provided a Second Opinion on Continuum's green bond framework and rated it CICERO Dark Green with a governance score of Good. The Dark Green rated underlying projects are within the renewable energy category, including wind farms, solar PV plants, and connected storage solutions. The underlying green bond projects will promote the transition to a low carbon, climate resilient growth and sustainable development in India. Continuum has no standalone renewable energy projects, all of Continuums projects will be connected to the grid and Continuum will sell renewable electricity to several high-polluting customers, including steel and cement producers.

Continuum has established sound procedures to ensure that environmental impacts are considered during construction and operation, as well as transparent allocation and impact reporting. Extensive Environmental and Social Impact Assessments (ESIAs) based on IFC performance standards are conducted for all projects, even if this is not currently required by Indian law. The investor should be aware that Continuum has included funding of access roads within the project site in their green framework and that project sites that might include dry forested land can be selected.

The full green bond second opinion is publicly available[1].

Green Hedge Assessment

According to the 2016 New Climate Economy report[2], "most loans require currency hedges that convert one currency to another over the life of the loan" due to the exchange risks and investor requirements. The report also states that "cheaper foreign debt is not an easy solution for middle income countries because of exchange rate risk" and in the Indian context costs of foreign debt could increase by up to 32% for utility scale wind projects. However, the report further finds for many countries that "foreign debt that was fully hedged against

[1] https://pub.cicero.oslo.no/cicero-xmlui/bitstream/handle/11250/2725289/SPO_Continuum_final%2012Jan2021.pdf

[2] https://newclimateeconomy.report/2016/wp-content/uploads/sites/2/2014/08/NCE_Chapter6_Finance.pdf

currency risk would have been more expensive than local debt, meaning that foreign debt is not a viable option for renewable energy project in these economies.” Further the report states that “other creative financing solutions for middle-income countries need to be scaled up”, with examples such as private supply agreements with companies, low-cost debt from commercial banks and concessional financing from multilateral trust funds.

Continuum Green Energy’s (“Continuum”) has established a Green Hedge Framework to support the implementation of its Green Bond Framework by hedging against the currency risk related to green bond projects. Continuum plans to use green bond project cashflows to finance the costs of the hedge (“green hedge”). According to Continuum, the company has committed to hedging currency risks for interest and principal payments related to green bonds in its offering memorandum. The exchange risk results from revenue from projects being in Indian Rupees and interest and principal payments in US Dollar. The hedge limits potential losses from green bond projects through currency exchange rate fluctuations to a smaller bandwidth. Deutsche Bank will be the only counterparty. The hedge is only applicable to the initial green bond issuance.

According to Continuum, the green hedge is dedicated to enable the issuer to manage the US Dollar to Indian Rupees exchange rate risks and depreciation over time. Continuum stated that investors were informed in the offering memorandum that it will always hedge its interest and principal payments under the green bonds to protect the issuer against any depreciation in the Indian Rupee to the US Dollar. According to the issuer, options used for the green hedge are Over-the-counter (OTC) transactions that are executed under ISDA documentation[3] and follow the protocol as prescribed by ISDA based on the agreed terms between two counterparts. Continuum confirmed that it will not further leverage these options and hedge will be carried out until maturity or earlier redemption of the hedged green bonds and not used for speculation. Continuum confirmed that the company will report on current hedging status in its green bond allocation reporting.

There are certain pitfalls associated with this green hedge: Investors should be aware that the green hedge is realized through investments in derivatives which are not directly linked to the assets as these could potentially be used for speculative purposes, that costs could be large and financial losses could be significant. According to Deutsche Bank and Continuum the hedge is not used for speculation or to hedge other risks (beyond this bond issuance) that Continuums may have. The issuer has confirmed that the amount of derivatives will be less or equal to the bond issuance volume and held permanently to manage the currency risks and will not sold on. Continuum has confirmed that the company will not seek to hedge more than the total volume of green bonds issued (no “double” or “over hedging”) and will report on the status of the hedge annually. CICERO Shades of Green finds that the green hedge and green bond projects are associated costs of the hedge which are being financed by the cashflows generated from the underlying projects funded by green bond proceeds. Hence these hedging costs could be financed directly by green bond proceeds under the framework and could therefore in this context be seen as a green activity (“green hedge”). Extra transparency on the hedging solution can be considered a strength.

Terms

CICERO Shades of Green provides a review of Continuum’s green bond hedge based on the green hedge framework provided by Continuum and Deutsche Bank, the term sheet and information gathered during teleconferences and e-mail correspondence with Continuum. Continuum is solely responsible for providing accurate information. All financial aspects of the green bond hedge and the green bond framework – including the financial performance of the bond and the value of any investments in the bond as well as the hedge – are outside of our scope, as are general governance issues such as corruption and misuse of funds or misuse of the hedge. In this type of transaction there is always counterparty risk which Continuum should be aware of. CICERO Shades of Green opinion does not constitute an endorsement of Deutsche Bank’s green hedge and does not validate nor certify the existence of the hedge as well as projects financed and does not validate nor certify the climate effects of the projects and the hedge. Our objective has been to provide an assessment on if the green hedge could be financed directly by green bond proceeds. The review is intended to inform Continuum’s management, investors and other interested stakeholders in Continuum’s green bond and green bond hedge framework and has been made based on the information provided to us. CICERO Shades of Green cannot be held liable if estimates, findings, or conclusions are incorrect. Our review does not follow verification or assurance standards and we can therefore not provide assurance that the information presented does not contain material discrepancies.

[3] https://www.isda.org/

Appendix 1:
About CICERO Shades of Green

CICERO Green is a subsidiary of the climate research institute CICERO. CICERO is Norway's foremost institute for interdisciplinary climate research. We deliver new insight that helps solve the climate challenge and strengthen international cooperation. CICERO has garnered attention for its work on the effects of manmade emissions on the climate and has played an active role in the UN's IPCC since 1995. CICERO staff provide quality control and methodological development for CICERO Green.

CICERO Green provides second opinions on institutions' frameworks and guidance for assessing and selecting eligible projects for green bond investments. CICERO Green is internationally recognized as a leading provider of independent reviews of green bonds, since the market's inception in 2008. CICERO Green is independent of the entity issuing the bond, its directors, senior management and advisers, and is remunerated in a way that prevents any conflicts of interests arising as a result of the fee structure. CICERO Green operates independently from the financial sector and other stakeholders to preserve the unbiased nature and high quality of second opinions.

We work with both international and domestic issuers, drawing on the global expertise of the Expert Network on Second Opinions (ENSO). Led by CICERO Green, ENSO contributes expertise to the second opinions, and is comprised of a network of trusted, independent research institutions and reputable experts on climate change and other environmental issues, including the Basque Center for Climate Change (BC3), the Stockholm Environment Institute, the Institute of Energy, Environment and Economy at Tsinghua University and the International Institute for Sustainable Development (IISD).