Lipstick on a pig: NAB's "sustainability" loan to coal

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"National Australia Bank (NAB) group executive David Gall says the world's biggest coal export facility, will be able to reduces its repayments if it meets social and environmental targets."

ABC Radio, 4 May 2021

We review the AUD sustainability linked financing (AUD515mn) on behalf of Australian bank and green bond issuer NAB to the world's biggest coal export terminal, the Port of Newcastle (terminals Waratah – capacity 25Mt coal per annum and Kooragang – capacity 120Mtpa, 2019 numbers).

Port of Newcastle (PON) is important for purposes of the global climate challenge. The throughput, 158MT in 2020[1], is equivalent to almost 0.5 gigatonnes of CO2 emissions, meaning that roughly 1-1.5% of global GHG emissions are carried across the quays of Newcastle. The port is a crucial component for the ongoing building of new coal mines in Hunter's Valley.[2]

Our views:

- The sustainability framework is not robust enough to make this a credible financial transaction aligned with Paris targets. Indeed, we argue directly the opposite.
- The acceptance of a climate-damaging loan as "sustainable" on behalf of NAB invalidates – through flow risks and credibility degradation - NAB's own frameworks for issuing green bonds. Specifically, investors in NAB green bond should be aware that the bank may very well use proceeds from their bonds for providing capital to the world's biggest coal port. General lenders to NAB should also be aware of the bank's coal financing activities.

Thus, we would consider stripping NAB of any green bond label that might have been applied previously. NAB clearly shows that it is looking to financially profit from a prolonging of one of the world's biggest coal operations, invalidating any hopes investors might have that the issuer is sincerely looking to contribute positively in the climate challenge. In the light of further construction plans for coal mines in the area, it is important that investors let it be known if they are not willing to co-finance such expansions through the balance sheet of NAB.

Affected "green" bonds are NAB EUR0.35 09/2022 (EUR500mn, issued 2017, XS1575474371), EUR0.625 08/2023 (EUR750mn, 2018, XS1872032369), USD3.625 06/2023 (USD750mn, 2018, US63254ABA51), and AUD4 12/2021 (AUD300mn, 2014, AU3CB0226090). Note the short maturities.

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[1] See " Coal exports from Port of Newcastle strong despite China's ban on Australian coal", ABC News, 15 Jan 2021. ~80-90% of PON's coal is thermal as opposed to metallurgical coal.

[2] See "NSW planning body gives green light to Hunter Valley coalmine expansion", The Guardian, 26 Apr 2021.

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Background

As the quote in the beginning indicates, the intention of NAB in this facility is to lower costs for the world's biggest coal export facility. To be clear, the value chain of coal has three direct steps and a final fourth indirect step. First, coal is mined (mining operations); second, the coal is transported (logistics); third, the coal is incinerated (typically utility companies), and lastly future generations monetize the climate destruction of the coal.

It is important to understand these steps in order to understand how investors are exposed to thermal coal. The first and third steps are fairly well understood: climate aligned investors tend not to invest in new coal mines or big new coal power plants. The intermediate second step is starting to come into focus as well, reflecting that an estimate 1/3 of coal production costs stem from the logistics associated with coal. Note that those logistic chains are often specialized for coal usages: you need special train and railway-lines, special port infrastructure etc.

So if an investor wants to make the burning of coal cheaper, they can invest in any part of the value chain. The lump of coal does not care if it gets 1 cent cheaper because of lower cost-of-capital for its mine, its logistics chain or it power utility.

When investors are up in arms because of State Bank of India's plans for lending USD670mn to Adani Enterprises, it is because they do not want SBI to lower the cost of the Carmichael coal mine and its associated coal output.[3]

When Pimco refuses to provide further bond financing to Adani Ports, and Deutsche Bank refuses to syndicate such bond deals, it is because of ADSEZ central role in coal infrastructure. But to be fair to Adani Ports, their North Queensland coal terminal (~20-25Mtpa coal capacity) is a mere baby sibling to the Port of Newcastle.

At this point, we would also like to make a revision to some of AFII's earlier work. It does not seem as if Brookfield's Dalrymple Bay port will actually become the world's biggest coal export terminal even with the recently announced "8x" expansion plan.[4]

Finally, we note that the loan facility announced comes on the back of a previous ANZ loan facility coming due in July. ANZ has been reported to not roll over the facility:

"The ANZ bank has pulled out of funding the Port of Newcastle in what is being interpreted as a significant rebuke of the coal industry and its exposure to climate risk."[5]

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[3] Please refer to the Anthropocene Fixed Income Institute's web-page: www.anthropocenefii.org for the coverage on the SBI/Carmichael loan. We would especially refer to "How green bonds are (not) supposed to work", AFII, 25 Nov 2020.
[4] Which coincidentally has been in the news at around the same time as Mark Carney's (POSITION AT BRK) criticized speech on Brookfield's net zero portfolio. Cf. "Brookfield: Coal and ESG mix like oil and water", AFII, 11 Feb 2021.
[5] "Climate risk seek ANZ divest from PON, the largest coal terminal in the world", ABC News, 9 Feb 2021.

Diving into the NAB/PON green frameworks

We refer to the documents provided by Port of Newcastle and NAB through the press-release dated 4 May 2021.[6]

"Port of Newcastle will have the opportunity to earn a margin reduction over the next five years on the sustainability-linked loans if it hit targets across a range of social and environmental metrics.

1. To keep Scope 1 and 2 GHG emissions below the 2025 trajectory level based on Port of Newcastle's *Well Below* 2-degree scenario
2. 100% of all existing and new suppliers active during the relevant calendar year screened for modern slavery risk and demonstrated engagement where medium or high risk is identified
3. Establish an Aboriginal and Torres Strait Islander student internship program with The University of Newcastle
4. Achieve accreditation of a number of mental health first aiders in each company department.
5. Demonstrated progression under the NSW Government Sustainability Advantage Recognition Scheme "

To be clear, the SLL only earns a reduction based on the the emissions of the port itself (Scope 1 and 2). This does not take into consideration any changes in the 150Mtpa coal throughput, which would be in terms of Scope 3 emissions. We estimate that the Scope 1+2 emissions of the port are equivalent to 0.0007% of Scope 3 emissions.[7] We are not making a moral argument around what is the right thing to do here, but rather highlight to investors in NAB bonds, that their money will be on-lent to one of the biggest coal facilities in the world. The sustainability link on this loan is extremely weak in comparison to the loan exposure to the coal value chain.

With regards to the other "criteria", they are laudable, but we would raise the following questions:

- 2. Is there a high risk for slavery operating on the East coast of Australia?
- 3. This should be a simple financial cost, and very marginal too. 1bp of AUD500mn is AUD50k. Let's hope PON spends at least that much on the internship.[8]
- 4. Diffuse: we would seek information on what accreditation, and what number.
- 5. We are unsure about the use of government accreditations given the large interdependence between the coal industry and the government, cf. NSW government's "Future of coal" statements.[9]

Finally, two points on how this framework may affect the "green" bonds NAB has issued itself.

First, we note that NAB is using the same second opinion provider for its own green bonds as it does for the PON deal. It is not impossible to see flows from NAB "green" bond proceeds into projects in this new PON loan structure, and using the same external verification accentuates that risk. Green bond investors should verify if this is possible.

Second, the intentionality of a green bond is – as we perceive the investor landscape –in general to mitigate climate change and investor tend to require that the issuers of green bonds are genuinely constructive in this challenge. Lowering the cost of coal burning is not constructive in that challenge. Again, we refer to the ANZ decision to divest from PON on the back of its coal exposure.

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[6] Available upon request.
[7] The Port indicates total CO2 emissions Scope 1+2 of 2333 tonnes in 2020 in its Sustainability report (p. 28).
[8] We would invite readers who are knowledgeable about those insitutions to flag this type of calculation to them, to see the potential for some real internship programme support.
[9] Refer to "Climate change: Australia wrestles with its coal mining dilemma", Financial Times, 5 May 2021.

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