# Financing sustainable city goals in Sweden: preliminary findings

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#### **Key findings**

- Swedish cities are actively working to become more environmentally and socially sustainable, and to be climate neutral
- Sustainability plans vary in their level of ambition and format;
   there is no national coordination
- External financing, for instance through the bond market, is not a bottleneck for achieving sustainability-related goals
- Green bonds have mainly been issued for non-financial reasons
- Most green bond issuers are not ready to issue social bonds
- Social impact bonds are not seen as a viable financing option, as they are perceived as too small-scale and too complicated

**Key words:** Sustainable cities, Agenda 2030, Green bonds, Social bonds, Financial instruments, Municipalities, Regions, Sweden







This discussion brief reports the preliminary findings of the first phase of a three-year research project (2020–2022) on investing in sustainable cities. The project takes a Swedish perspective and is part of the strategic innovation programme Viable Cities. The innovation programme's mission is to speed up the achievement of climate neutral cities, thereby providing a good life for everyone within the planet's boundaries.

#### Sustainable cities

More than half the world's population live in cities and it is estimated that this proportion will to grow to over 60% by 2030. While urbanization can generate economic prosperity at both the individual and the community level, it also takes a toll on the planet and its people. Cities and metropolitan areas currently account for about 70% of global carbon emissions and over 60% of resource use.

In Sweden, 85% of the population lives in cities. Sweden has made good with achieving Sustainable Development Goal (SDG) 11 on making cities inclusive, safe, resilient and sustainable. Nonetheless, a number of challenges remain, not least curbing transport emissions, addressing growing segregation, stratification and security issues, and satisfying the need for more housing and accessible public transport.<sup>2</sup>

Local municipalities and regions in Sweden largely rely on taxes as their primary source of income, and thus to finance their Agenda 2030 ambitions. That said, many municipalities also rely on external funding to some extent and some of this funding has a sustainability tag attached to it. Several Swedish cities and regions have issued green bonds to finance green activity through the private market. This study is interested in exploring and analysing the relationship between sustainability plans and financing.

#### **About the study**

The purpose of our three-year research project is to: (a) understand what Sweden's plans for sustainable cities entail—their focus, how goals are defined and the metrics used—and whether they are likely to achieve Agenda 2030 and climate neutrality; (b) how the plans are budgeted for, how this matches available resources and whether there is a funding gap; and (c) the extent to which external capital plays or could play a role in financing achievement of these sustainability-related plans. Ultimately, we are interested in understanding whether a framework for a "sustainable city bond" or something similar would be useful and how it might be designed.

The preliminary results presented in this discussion brief build on two main inputs. First, we conducted an analysis of the sustainability-related plans of the nine Swedish municipalities and three regions that have

1) Viable Cities https://en.viablecities.se/

2) Sweden on target for SDG 11: Preparing for an urban future https://sustainabledevelopment.un.org/content/documents/20047rk\_25106\_global\_agenda\_goal\_11.pdf

issued a green bond (see Table 1). This selection was made based on the assumption that issuers of green bonds might be more likely to seek external and sustainability-labelled financing, as one of the purposes of the study is to understand the role of external financing and the potential for a sustainable city bond framework. We collected the publicly available sustainability strategies of each of the municipalities and regions, and mapped them against the Urban Sustainability Framework, which is an integrated approach to helping cities to understand their urban sustainability status.

Our project will map these strategies against other standard frameworks to analyse how the goals and indicators are defined and how they plan to measure success. We are also conducting semi-structured interviews with finance directors and sustainability directors. Thus far, we have interviewed representatives of six of the nine municipalities and one of the three regions. All the interviews will be completed by November 2020.

Municipalities
Gothenburg
Linköping
Lund
Malmö
Nacka
Örebro
Östersund
Västerås
Vellinge

Regions
Region Stockholm
Region Skåne
Västra Götalandsregionen

Table 1: Swedish municipalities and regions that had issued green bonds by 2020

#### Sustainability plans: a mixed bag

There are no national recommendations on or frameworks for how municipalities and regions should work to achieve sustainability in Sweden, and no other forms of coordination. All the municipalities and regions in our study have sustainability agendas integrated into their budgets and plans but the level of ambition differs. Some municipalities have visions rather than goals, while others are developing fully integrated sustainability programmes with targets and indicators for 2030 and even 2050.

For example, one municipality has city council goals on urban development, the climate, employment, education and safety, and progress is monitored using around 330 indicators. This municipality plans to integrate the Agenda 2030 goals to a greater extent so that politicians can make decisions based on the holistic picture that constitutes Agenda 2030.

Another municipality, by contrast, told how it has chosen not to set goals for its work on Agenda 2030 but instead to develop indicators that show the direction in which it would like to travel. The reason for not setting goals is that if they are not achieved, the auditors will make detrimental judgments about it.

The Urban Sustainability Framework is a guide created by the Global Platform for Sustainable Cities. It is aimed at help cities improve in holistic sustainability from a strategic perspective and offers tools to assess and measure performance. Its main promoters are the World Bank and the Global Environment Facility.

Agenda 2030 is often seen by the participants in our study as an exante mapping exercise rather than a strategic tool. One municipality, however, recently initiated a 10-year plan with the aim of defining the city council's goals according to Agenda 2030 rather than the other way around.

Climate and social issues tend to dominate the sustainability plans. Some issues are commonplace—all of the plans that we reviewed include housing—while some contain "unique" issues. Reducing poverty, for instance, was found in only one plan. Many of the interviewees see sustainability as an underlying and integrated part of their everyday activity.

The interviews identified a disconnect between some of the sustainability-based projects and the finance department. In some municipalities, groups working on implementing specific technologies or projects have little or no contact with the finance department, which could provide funding for them. This silo effect is a potential bottleneck to achieving more ambitious sustainability-related goals, and this will be explored further by our project.

Regions have a different role to municipalities: A large share of the regions' activities is focused on healthcare and their remaining work is mostly on public transport and regional development. One region is currently developing environmental goals to 2030 with the aim of creating financial management that is aligned with the Paris Agreement.

Municipalities are politically controlled, which means that their sustainability approach, including any goals and indicators, is subject to change following changes in political control. One municipality had 20 sustainability-related goals abolished when a new administration took over. Some of its employees are still working towards those targets, but only unofficially. There are currently no sustainability-related focus areas and no specific goals. Another municipality mentioned that it currently had a major focus on social issues but this might change with a change in political control. A third city mentioned that when developing its sustainability programme, it had been careful to involve all political parties and civil society in order to achieve a consensus on the long-term goals and strategies.

## Financing sustainable cities: the role of external funding

Swedish municipalities and regions raise about 70% of their revenue from a locally generated income tax. General and earmarked grants constitute a further 16% and local charges and fees 10%. The Swedish Constitution provides municipalities and regions with autonomous tax raising powers.<sup>4</sup>

The Swedish municipalities and regions in our study stated that the availability of external financing is not an obstacle to achieving the goals of Agenda 2030 as municipalities are able to borrow funds for capital expenditure and interest rates are currently low. The fact that

<sup>4)</sup> Public finance system overview: Swedish local and regional governments https://kommuninvest.se/wp-content/uploads/2015/06/5.2-SP-Public-Finance-System-Overview\_May-2011.pdf

it is inexpensive to borrow makes funds easily accessible should the need arise. However, there are some limitations on municipal borrowing powers as external funding can only be used for capital expenditure (CAPEX), such as for building a school. The operational costs derived from those investments, such as the school management expenditure (OPEX), be it on heating or salaries, can only be funded from tax-based income. Therefore, future costs will limit current investment. One interviewee pointed out that generating more jobs in order to increase the tax base was the way the authority would usually seek to expand the scope of CAPEX investments. In addition, the ambitions for sustainable investments were also limited by the capacity of the municipality. Small municipalities in particular may not have the resources for implementation to match the potential for external funding.

All of the municipalities and regions interviewed for our study have issued green bonds. The main reason for the green bond issue varied but it was rarely the financial case that underpinned it, even if there might have been a "greenium" allowing the issuer to borrow funds at a few basis points lower than conventional bonds. A few interviewees said that the green bond was a good marketing opportunity for the municipality's sustainability projects. One municipality explained its green bond as a way to avoid public criticism for taking funds out of the health budget to finance green investments. Green bonds thus become a way of financing projects that might not be seen as core activities by key stakeholders. One interviewee explained that part of the motive was to contribute to greening the financial market so that investors would have greater green investment opportunities.

Several interviewees pointed out that they could have funded their investments without a green bond. One stated that it did not really matter to the municipality whether the funding was green or not. It is the investors that are keen on the green labelling.

The interest in extending labelled bond issuance to social bonds is quite low. Some municipalities have looked into it but are hesitant as they do not want to act as pilots. It is considered harder to measure the effects and impacts of socially oriented assets than green assets, and many projects are regarded as too small. The fact that municipalities are generally not in need of capital also makes it less of a priority, and when they do need funds this is often for social activities that tend to require operational rather than capital expenditure, which cannot be funded through debt acquisition.

One municipality rejected a suggestion to issue a social bond because opponents argued that a labelled bond would lead to the financial sector placing conditions on its investment decisions, which would undermine the democratic process.

Social impact bonds (SIBs) are an outcome-based contract rather than an actual bond through which private actors can invest in and support social projects in the public sector. Thus far, only two Swedish municipalities (Norrköping and Botkyrka) have issued SIBs. The interviewees in our study do not see SIBs as an attractive option for partly funding their sustainability agenda. They argue that the level of funding is too small (Norrköping's SIB is SEK 10 million) and that they

are too "complicated" to set up. One participant referred to SIBs as "too academic" while others were not familiar with the concept. According to some of the respondents, politicians may also be reluctant to embrace financial innovations.

### The road ahead: A framework for sustainable city bonds?

The key findings from the city sustainability plan analysis and the interviews conducted show that Swedish cities are actively working to become more environmentally and socially sustainable and to be climate neutral. However, the lack of national coordination means that sustainability varies greatly in ambition, focus and format.

In terms of financing the sustainability plans, access to external financing does not seem to be a bottleneck in plan implementation. That said, a growing taxpayer base will be needed if cities are to be able to fund operations linked to new investments. We found that green bonds have mainly been issued for non-financial reasons. We also found that green bond issuers are not ready to issue social impact bonds as they are seen as too small and too complicated to be a viable financing option for cities and regions.

Green bond frameworks such as the Green Bond Principles lack the holistic sustainability perspective that a city requires in order to include aspects such as health, social integration and education. In fact, an international assessment few of the 166 sustainable bonds on the global market support a holistic perspective on sustainable cities. Only one sustainable bond has been issued in Sweden, and that focused solely on housing.

We are probing our interviewees further on whether they think a framework for sustainable city bonds would be useful. Such a framework could be aligned, for example, with EU guidelines on achieving SDG 11 on sustainable cities. Thus far, we have received a mixed response. While some see it as an idea worth exploring further, others feel that it would not add much value to their work but perhaps be more useful to investors keen to showcase their fulfilment of a sustainability-related investment mandate.

The next phase of this study will provide a systematic analysis of all the interviews with municipalities and regions. It will also include a round of interviews with investors and intermediaries, in order to gain an understanding of the interests and motivations of external funders vis-à-vis local and regional government. We also intend to expand our analysis to include municipalities and regions in other countries, for comparative purposes.

<sup>5)</sup> Vanhuyse, F., Chan, S. and Gill, T. (2020). Bonds Beyond Green: Results of the Scoping Study on Sustainable City Bonds. Stockholm Sustainable Finance Centre, Stockholm. www. stockholmsustainablefinance.com/sustainable-bonds