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The voice of our sustainable built environment

GREEN & SUSTAINABILITY LINKED LOANS

PRACTICAL GUIDE

This guide provides a short overview of green loans and sustainability linked loans (SLLs). It is one of a series of guides focused on finance products which can support the net zero transition.

IN A SNAPSHOT

A loan is a sum of money that one or more individuals or companies borrow from banks or other financial institutions so as to financially manage planned or unplanned events.

- Green loans are used to finance green projects such as those focused on reducing CO_2 emissions or developing environment friendly goods and services.
- Sustainability linked loans incentivise the borrower's achievement of ambitious, predetermined sustainability performance objectives. Their terms, especially the interest rate, are dependent on the borrower's sustainability performance.

TRANSITION FINANCE VS GREEN FINANCE

The European Commission defines sustainable finance in the following way: " Sustainable finance is about financing both what is already environment-friendly today (green finance) and what is transitioning to environment-friendly performance levels over time (transition finance)".

The increasing importance of sustainable finance

Sustainable finance increasingly rises on the international agenda. At Cop28 (2023), 13 national governments, including the UK, endorsed the Declaration on a Global Climate Finance Framework focused on making finance available, accessible and affordable and unlocking the investment opportunities associated specifically with climate related finance.

According to the Intergovernmental Panel on Climate Change's (IPCC) Sixth Assessment Report, annual climate finance flows need to increase by a factor of three to six to meet the average annual needs of all regions and sectors to align with the Paris Agreement.

Green bonds are one of the main mechanisms for sustainable financing with the global green bond market growing at an average annual growth rate of about 95% since the first green bond was issued in 2007.

SLBs first emerged in 2019. Since then the market has experienced huge growth globally from $9 billion in 2020 to $100 billion in 2021.

Investors, financiers and lenders have a crucial role to play in accelerating the transition to net zero carbon assets.

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More about green loans and sustainability linked loans

Green loans

Green loans are defined in the Green Loan Principles (GLPs) as any type of loan instrument exclusively for financing, re-financing or guaranteeing existing eligible Green Projects.

These are aligned to the four core Green Loan Principles (Use of Proceeds, Process for Project Evaluation and Selection, Management of Proceeds, and Reporting) and provide a high-level framework of market standards and guidelines, to ensure consistent international methodology, whilst also allowing the loan products to retain flexibility.

The GLPs aim to support issuers in financing environmentally sustainable projects that drive the transition towards a net-zero carbon economy and have positive climate impacts. They consist of voluntary recommended guidelines that can be applied by issuers and borrowers on a case-by-case basis. The GLPs recognise several broad categories of eligibility for Green Projects with the objective of addressing key areas of environmental concern such as climate change, natural resources depletion, loss of biodiversity, and air, water and soil pollution.

Sustainability linked loans

Sustainability linked loans (SLLs) motivate borrowers to achieve specific environmental, social, and governance (ESG) goals. SLLs are any type of loan instruments which incentivise the borrower's achievement of ambitious, predetermined sustainability performance targets. The Loan Market Association (LMA) model for SLLs provides a framework for drafting SLL provisions, the Sustainability Linked Loan Principles.

SLLs are carried out by linking the loan terms, particularly the interest rate, to the borrower's, achievement of predefined sustainability performance targets. The borrower commits to specific ESG goals, such as reducing carbon emissions or improving energy efficiency.

Progress towards these targets is regularly monitored and reported, often verified by an independent third party. If the borrower meets or exceeds targets, they benefit from favourable loan terms, such as reduced interest rates; failure to meet the targets may result in less favourable terms.

Availability and application

Green or sustainability linked loans are accessible to all types of organisations and individuals, provided that they meet the lender's eligibility criteria and can demonstrate the environmental benefit of funding the given project.

Large corporations often have the resources and capacity to implement substantial green projects, such as building or retrofitting sustainable manufacturing facilities, investing in extensive renewable energy installations, or launching comprehensive sustainability programmes.

Small and medium-sized organisations may typically use green loans to fund sustainable business-related initiatives such as energy efficiency retrofits, transitioning vehicles to electric or hybrid options, or investing in renewable energy projects.

Local governments can also use green loans for city-wide sustainability projects such as improvements to transportation or the development of green infrastructure.

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Examples:

Green loans

In 2021, ING provided Hines with its first green loan. This green loan financed an urban logistics park near Heathrow airport as well as a €40 million facility for a prime office building in Frankfurt. Both assets recorded above-average energy performance levels and were awarded sustainability certificates.

Also in 2021, Newport City Council began working with Egni Co-op to install 6,700 solar panels across 27 sites, work part funded by a green loan from the Development Bank of Wales. The programme of work enabled operational energy savings of over 300 tCO_2e per annum as well as reducing energy costs compared to the previous electricity supplier.

Sustainability linked loans

In January 2022, Frasers Property obtained a £110 million five-year bilateral SLL for its UK subsidiaries, Frasers Property (UK) Limited (FPUK) and Hillington Park. This loan will be used to finance the majority of their new asset portfolio with green and/or sustainable funding. FPUK aims to achieve net zero carbon in all landlord-controlled areas by 2030, in line with the Better Buildings Partnership Climate Change Commitment and the Science Based Targets Initiative (SBTi).

A further example is the Metropolitan Thames Valley (MTVH), the G15 housing association which agreed to a £100 million SLL from the European arm of Mitsubishi UFJ Financial Group to aid in the provision of affordable homes throughout the UK. The MTVH expects this loan to support the delivery of 1,000 homes a year across the UK, starting with 815 houses in the 2023-24 financial year.

IN SUMMARY

Green loans and sustainability linked loans can be used to finance environmental and sustainability initiatives. Green loans are aligned to a fixed set of green loans principles, sustainability linked loans are offered by tying interest rates to performance across a number of environmental indicators agreed between the lender and borrower.

Both types of loan are offered by banks and other financial institutions and are of particular value to support the net zero transition due to their comparative readiness of access.

FURTHER RESOURCES

- Loan Market Association: Green Loan Principles
- World Bank Group: What you need to know about green loans
- ICMA: Sustainability Linked Loan Principles
- Sustainable Capital Group: How to structure sustainability-linked loans: The ultimate guide
- Taylor Wessing: Sustainability-linked loans: Aiming high and delivering
- LexisNexis: A Beginner's Guide and Checklist for Accessing Sustainability Linked Loans (SLLs) (The Chancery Lane Project)
- Norton Rose Fullbright: Sustainability-linked loans: practical observations and thoughts