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LMA GUIDANCE ON GREEN LOANS

Introduction

Green Loans are becoming increasingly common in loan markets, enabling borrowers to promote environmental sustainability and also providing a number of ancillary benefits for businesses; including enhanced reputation and credibility; access to socially conscious investors seeking investments with a positive environmental, social, and corporate governance focus; and increased attractiveness to skilled employees whom increasingly value environmental considerations.

In the real estate lending market, "green" finance is playing an increasingly important role in light of the net-zero emissions targets by 2050 set by the EU for Member States. These targets are set to be incorporated into Irish law by the Climate Action and Low Carbon Development (Amendment) Bill 2020. As buildings account for approximately 40% of energy consumption and 36% of CO_2 emissions in the EU, significant emissions reductions will need to be achieved in respect of buildings in order to reach these targets.

In this article, we examine recently published guidance from the Loan Market Association (the "**LMA**") on the application of the Green Loan Principles (the "**Principles**") in the context of lending for real estate retrofit projects ("**RERF**") (available here) and highlight some notable market trends.

What are Green Loans?

Green Loans are any type of loan instrument made available exclusively to finance or re-finance new and / or existing "Green Projects". The LMA have set out a non-exhaustive list of indicative categories of Green Projects, including, but not limited to:

- renewable energy;
- energy efficiency;
- pollution prevention and control;
- climate change adaption;
- green buildings; and
- sustainable water and wastewater management.

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The distinguishing feature of a Green Loan is that the loan proceeds must be utilised for a designated Green Project, which should be adequately described in the relevant finance document and marketing materials of the borrower. Green Loans must also comply with the four core components of the Principles, which are considered in more detail below.

The Principles

In 2018, the LMA, together with the Asia Pacific Loan Market Association and the Loan Syndications & Trading Association, produced the Principles with the goal of establishing a high level framework of industry standards which aim to provide a consistent methodology for use across the Green Loan finance market. The Principles consist of four core elements:

1. Use of Proceeds;
2. Process for Project Evaluation and Selection;
3. Management of Proceeds; and
4. Reporting.

1. Use of Proceeds

As outlined above, in order to be deemed a Green Loan, the proceeds of such loan must be applied to a Green Project. In addition, all designated "Green Projects" should provide clear environmental benefits, which will be assessed, and where feasible, quantified, measured and reported by the borrower. A Green Loan may take the form of one or more tranches of a loan facility. In such circumstances, the green tranches should be clearly designated with any proceeds being credited to a separate account or tracked by the borrower in an appropriate manner.

As this is an area of loan financing which is constantly developing, there is not one single determining factor of what currently constitutes a Green Project in the RERF context. However, the LMA have said that it expects RERF projects to result in a material improvement in the energy efficiency of, and consequently, a material reduction in the carbon emissions associated with the building or buildings being financed. Examples of such projects include improvements to basic and enhanced efficiency measures, more environmentally friendly heating and energy generation and the installation of resilience products to protect against flooding and heat-waves.

Whilst existing industry standards such as BREEAM and Trustmark can be used to assess the "greenness" of a particular project, the LMA have acknowledged that there are gaps in the data currently available to borrowers and lenders as they seek to make such assessments of RERF projects. However, it is pointed out that there has been a significant growth in the availability of data in this area which can be used to assist lenders in setting thresholds for the post-retrofit energy performance of a building or project.

In determining whether a particular project qualifies as a Green Project, the LMA have confirmed that lenders may set their own eligibility criteria, or rely on external reviews, or make determinations on a case-by-case basis. Borrowers may also produce a "green finance framework" document, setting out the eligible Green Projects in respect of which loan proceeds will be applied. Although this is not a requirement under the Principles, the LMA have said that such documents assist in increasing transparency and avoiding any potential "greenwashing" in a RERF project. "Greenwashing" refers to circumstances where a borrower or a specific project, is incorrectly stated to have green credentials (or has exaggerated such claims), thereby undermining the integrity of the loan product and undermining investor confidence as well as the potential reputational damage caused to the lender as a result.

The use of proceeds is a key determinant of a Green Loan. Accordingly, any breach of the use of the proceeds provisions should be taken seriously and the loan should be not be considered "green" from the date of occurrence of such event, subject to any cure rights. Parties should give due consideration as to whether or not a failure to apply the proceeds of a green loan towards a green project will trigger an event of default, and a subsequent cross-default across outstanding loans.

2. Project Selection and Evaluation

In order to obtain "green" financing, a borrower must convey to its lender:

- the environmental sustainability of a project;
- the process by which a project satisfies the eligibility criteria laid down by the Principles; and
- the relevant processes used to manage environmental risks associated with a project.

In the context of financing applications for RERF projects, the above information should be packaged within the borrower's overall strategies and policies relating to environmental sustainability. The "green finance framework" document (referred to above) is another useful method of communicating this information to lenders.

3. Management of Proceeds

Funds allocated pursuant to a Green Loan should be assigned to a specific bank account or tracked in some other manner which ensures that funds are readily identifiable. Where a Green Loan takes the form of one or more tranches of a loan facility, each "green tranche" must be clearly designated, with proceeds of the green tranche(s) credited to a separate account or tracked by the borrower in an appropriate manner.

Although it is not a requirement, the Principles recommend that borrowers implement an internal governance process to track the allocation of funds utilised for Green Projects, ensuring further compliance in this regard.

Additionally, borrowers will often have to provide undertakings and representations in the facility agreement regarding the use of the proceeds for eligible Green Projects. Such undertakings and representations act as a means of ensuring that Green Loans are, in practice, applied for their intended purpose, acting as a further guard against "greenwashing". Failing that, the LMA highlight the following alternative means of ensuring that funds are utilised for a Green Project":

- the provision of a funds flow statement as a condition precedent to drawdown, accompanied by an undertaking to apply the proceeds of the loan in accordance with the funds flow statement;

- a requirement to provide invoices to verify the use of funds as a condition precedent to each utilisation; or
- verification by a third party as to the use of proceeds.

4. Reporting

The LMA have stated that borrowers should ensure that all information relating to the use of proceeds of the loan is readily available and kept up to date and should be reported at least annually until funds have been fully drawn down, and thereafter in the event of any material developments. This should include a list of the Green Projects to which the proceeds of the Green Loan have been allocated, including a brief description of the projects, the amounts allocated and their expected impact. This will further enable borrowers to track the relevant funds, ensuring further compliance with the Principles.

Borrowers may also be required to report to lenders on the in-use performance of the relevant properties (for example, energy or water consumption) where this has been agreed as a pre-condition for the provision of a Green Loan. All reporting obligations should be clearly set out in the RERF project facility agreement and where a borrower has a “green finance framework” in place, this should be updated to include its relevant reporting obligations and commitments.

The LMA highlight the importance of transparency in reporting the impact of Green Projects and recommend the use of qualitative performance indicators, and if possible, quantitative performance indicators (for example, energy capacity / generation, greenhouse gas emissions impact etc.).

Conclusion

There is little doubt as to the importance of the role that Green Loans will play in the coming years. As Europe aims to achieve its net zero emissions targets by 2050, given that almost 75% of buildings in the EU are energy inefficient, substantial investment will be required in an RERF context. The LMA have acknowledged that it is unlikely a single standardised approach can or will be adopted, as there will be substantial differences between various projects and buildings; however, the Principles together with the latest guidance from the LMA on RERF projects help establish a solid framework as to the criteria for such financing arrangements.

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