LMA Green Loan Principles Snapshot

The *Green Loan Principles* (*GLPs)* are a set of voluntary guidelines issued by the Loan Market Association to aid the development of a market-standard approach to green lending. The *GLPs* require specific methodologies to be applied to a *green loan* i.e. any type of loan instrument made available exclusively to finance or re-finance, in whole or in part, new and/or existing eligible *Green Projects* (see below).

What is a Green Project? All designated green projects should provide clear environmental benefits, which will be assessed, and where feasible, quantified, measured and reported upon by the borrower. There are 10 eligible categories of green loan which range from renewable energy, energy efficiency, pollution prevention and control to clean transportation and climate change adaptation and green buildings *which meet regional, national or internationally recognised standards or certifications.*

Green Loan Principles Methodology

The GLPs require the following components to be present in a green loan:

1. use of proceeds for a clear environmental benefit
2. project evaluation and selection processes articulate environmental objectives
3. the proceeds of the project should be allocated towards other green projects
4. appropriate reporting should be carried out to evidence the satisfaction of these requirements

Use of Proceeds

The fundamental determinant of a green loan is the utilisation of the loan proceeds for green projects and expenditure relating to that green project, including R&D.

A green loan may take the form of one or more tranches of a loan facility and may relate to the entire financing or part; however in all cases, the monies to be applied to the green purposes must be specified and segregated from other monies. Funds can be used, in whole or part, for refinancing a green project where the purpose and assets are clearly identified.

Process for Project Evaluation and Selection

The loan documentation should clearly identify:

— the borrower’s agreed objectives;

— the method by which it is established that those objectives are a green project;

— any relevant criteria to be applied to the green project (directly and indirectly);

— any applicable green standards or certifications.

Management of Proceeds

The proceeds of a green loan should be channelled separately from all other proceeds advanced under the same loan documentation so that they can be identified and their application demonstrated to the green project demonstrated. Corporate processes should provide this “green audit trail”. This should be easy to satisfy by way of a funds flow statement where, for example, the green project is the acquisition of a green building.

Reporting

The loan documentation should provide for the lender's ability to require evidence and information on the compliance with the above three methodologies, whilst the funds are being advanced, and ideally, for the life of the loan (particularly if matters arise which have an impact on the green project). This ongoing reporting is an extension to, but not wholly different from, the usual recording and reporting that a borrower would be expected to do in respect of its compliance financial covenant and other key metrics and allows both parties to confirm whether the loan still qualifies for green loan status.

The *GLPs* recommend the use of "qualitative performance indicators" and "quantitative performance measures (for example, energy capacity, electricity generation, greenhouse gas emissions reduced/avoided, etc.) and disclosure of the key underlying methodology and/or assumptions used in the quantitative determination". Borrowers are encouraged to report on impact as much as possible.

Other green loan considerations

External verification of a green project

Given the lack of technical specificity as to what a green loan is borrowers have sought external guidance from consultancies, industry standards and rating agencies in order to validate and confirm the approach and benefits of their proposed green projects by way of the following:

— **Consultant review** – a borrower can seek advice from consultants and/or institutions with recognised expertise in environmental sustainability or other aspects of the administration of a green loan for example a "second party opinion" issued in confirmation of the satisfaction of the GLPs at the outset of a green loan.

— **Verification** – a borrower can have its green loan, associated green loan framework, or underlying assets independently verified by qualified parties, such as auditors or independent ESG rating providers. In contrast to certification, verification may focus on alignment with internal standards or claims made by the borrower.

— **Certification** – a borrower may have its green loan or associated green loan framework certified against an external green assessment standard. An assessment standard defines criteria, and alignment with such criteria is tested by qualified third parties/certifiers. An example of a certification regime in the real estate sector would be BREEAM, a sustainability assessment method for infrastructure and buildings.

— **Rating** – a borrower may choose to have its green loan or associated green loan framework rated by qualified third parties, such as specialised research providers or rating agencies. This review may cover certain aspects of a borrower's initiative or comprehensively assess alignment with all the entire GLP methodology. It should be made available to all institutions participating in the green loan on request.

Defaulting and Enforcement

The GLPs do not propose what the consequences of non-compliance with the various "green" methodologies should be. Whether there is no effect, and the loan effectively converts to a conventional loan, or a breach results in a default and the right to demand repayment will be up to the lender. There should however be some consequence if the loan ceases to qualify as a green loan.

Are Green Loans Cheaper?

The market appears to be undecided as to whether green projects should derive a financial benefit from reduced margins. Some borrowers take the view that they should enjoy an advantage from undertaking such projects and complying with an increased informational compliance burden which may entail additional costs. On the other hand, financial institutions argue that there should not be any margin differential (a) the borrowers derive a benefit from being able to advertise the fact that they maintain a green loan and the related good publicity around this and (b) each business should be transitioning towards sustainability in any case and this product simply allows them to do so. Our practice has seen green loans with and without margin ratchets and we expect that this will continue to be the case depending on the borrower, asset class and sector as the market evolves.

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