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New Standards to Drive U.S. Sustainability-Linked Lending.

NEW YORK (LPC) – Global standards set in place by loan trade associations this week that tie syndicated loan pricing to companies' sustainability performance are expected to stimulate the budding U.S. green lending market.

Less than a handful of U.S. companies have issued sustainability-linked loans since the first deal for natural gas utility CMS Energy was completed last June, far lagging firms in Europe which are leading the global push to improve environmental performance.

The new sustainability standards, which were issued on Wednesday by the Loan Market Association (LMA), the Loan Syndications and Trading Association (LSTA) and the Asia Pacific Loan Market Association (APLMA), are expected to bolster borrowers' and investors' confidence in green lending.

Sustainability-linked loans are any kind of loans that incentivize borrowers with margin reductions or increases depending on their ability to meet pre-set environmental performance targets.

A lack of direction and consistency in being able to identify and measure these goals has been stifling growth so far, bankers said.

"By having pricing tied to a borrower's improvement in sustainability performance, it directly incentivizes borrowers to make improvements," said Tess Virmani, the LSTA's associate general counsel. "If market interest keeps gathering steam, then the sustainability-linked loans will find a good home in the corporate loan market."

One of the main differences between sustainability-linked loans and green loans, which are linked to use of proceeds, is that they can be raised for general corporate purposes rather than specific projects. Loans for general corporate purposes are more widely issued, which is likely to boost sustainability-linked loans.

Key characteristics of sustainability-linked deals include disclosing the loan's tie to the company's overall social responsibility strategy; having sustainability pricing targets arranged between borrower and lender; reporting on sustainability performance and external reviews, according to the new lending principles.

TESTING THE WATERS

Global water technology company Xylem Inc became the fourth U.S. company to issue a sustainability-linked loan, with an $800 million revolving credit in early March. Xylem is the first general industrial company to commit to reducing its environmental footprint this way.

The four U.S. sustainability-linked loans that have come to the market so far — two this year and two last year — tally roughly $8 billion. Banks are targeting the sector as a growth area as they seek to improve their own credentials.

"Banks want to show their growing commitment to sustainable development goals, and this is one of the products they might use to show that," said Anna Zubets, vice president at Moody's Investors Service.

Last year, sustainability-linked loans issued globally topped $36 billion, led by European companies, according to Moody's.

Global issuance in the more mature green bond market, in contrast, could jump 20 percent to $200 billion this year, the rating agency said.

"The U.S. is a little behind on the discussion but you see it happening here as well. More than 80 percent of the S&P 500 listed companies are now issuing sustainability reports and it becomes a bigger discussion among shareholders and investors and asset managers, which is what we see among our client base," said Anne van Riel, head of sustainable finance at ING.

"I expect that that will automatically carry over to more sustainable financing, whether green loans, green bonds or sustainable-linked loans."

ING was the sustainability coordinator for Xylem's deal, and helped the company to decide reasonable but ambitious performance targets to guide loan pricing.

Interest margins on Xylem's general corporate purpose revolving credit will be based on social and corporate governance ratings by independent provider Sustainalytics. Citigroup, JP Morgan, ING, BNP Paribas and Wells Fargo were lead arrangers and bookrunners.

Pricing is initially based on ratings, opening at 110 basis points over Libor with a 15-basis points facility fee, and then will be adjusted up or down by up to 5 basis points based on its ability to achieve predetermined sustainability targets, according to a regulatory filing.

The other sustainability-linked loans completed in the United States so far include global logistics real estate group Prologis Inc in January, renewable energy and utility company Avangrid Inc last July and electric and natural gas utility CMS Energy and its main unit Consumers Energy last June.

"Some treasurers and CFOs are a bit more conservative, and when they see their peers doing it or see more market activity they will also follow," said van Riel.

Having clear standards for the asset class is a way to hold management accountable for promises made, and make green identification more than a marketing tool.

"In order for money to continue to flow into these kinds of products, reporting standards are going to have to develop and mature so the market can be credible and management can be held accountable for goals," Zubets said,

"Investors can have trust that if something is labeled as green it is actually going to deliver an impact."

Reuters

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