C A D W A L A D E R

Green Loans Series, Part 2 – The Four Core Components of the Green Loan Principles

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In our February edition of *REF News and Views,* we introduced the Green Loan Principles ("GLP") that were published by the Loan Market Association ("LMA"). The GLP seeks to help facilitate and support environmentally sustainable economic activity by providing a framework of market standards, guidelines and methodology that can be consistently adopted across the green loan market.

One key point regarding the GLP is that they are currently still voluntary and for guidance only, so it is ultimately incumbent on the lenders to define their internal standards with regards to eligibility criteria for what they would classify as a green project. This being said, we fully expect to see continued growth in the use of the GLP as the guiding core principle for green loans products, as well as an evolution and development in the GLP, over the coming years.

In this article we dive deeper into the GLP to discuss each of its four core components.

The four core components of the GLP

To qualify as a GLP-compliant green loan, such loan product must align itself with the following four core components: (1) use of proceeds; (2) process for project evaluation and selection; (3) management of proceeds; and (4) reporting.

1. Use of proceeds

Under the GLP, the utilisation of the loan proceeds must be for green projects that provide clear environmental benefits that can be assessed, quantified and measured by the borrower. Such purpose should be appropriately described in the finance documents and, if applicable, marketing materials. Such projects should be aimed at addressing key environmental concerns, such as climate change, natural resource depletion, loss of biodiversity and pollution.

The GLP recognises a number of broad categories of projects as having such an objective; these include renewable energy, energy efficiency, environmentally sustainable management of living resources and land use, sustainable water and wastewater management, and climate change adaption. However, the GLP does not provide an exhaustive list as it recognises that green projects may vary depending on many factors such as sector and geography.

2. Process for project evaluation and selection

The GLP requires the borrower to communicate (i) its environmental sustainability objectives, (ii) the process by which the borrower determined that its project fits within the GLP green project eligibility criteria, and (iii) the related eligibility criteria including, to the extent applicable, any excluded criteria and the processes to be applied to identify and manage potentially material environmental risks associated with the project.

3. Management of proceeds

The GLP recommends that the proceeds of the green loan are tracked in an appropriate manner to promote and maintain transparency and integrity of the green loan product. This can be achieved in many ways − for instance, by separating out a specific tranche of the facility that shall be designated to the green project, or for the green loan funds to be credited to a dedicated account.

4. Reporting

The GLP recommends borrowers to keep readily available up-to-date information on the use of proceeds and details of material developments. This should include details of the green projects and the amounts to be allocated, together with their expected impact. It is clear in the GLP that transparency is of particular value in communicating the expected impact of the green projects. As such, the GLP recommends the use of qualitative performance indicators and, where possible, quantitative performance measures, as well as the disclosure of key underlying methodology and/or assumptions used.

Next month

Whilst the GLP is intended to support the general expansion of the market for sustainable finance products, it is also intended to be used in a real estate-specific context, and in October 2020 the LMA published two guidance papers to specifically address some of the more frequently asked questions on the application of the GLP in real estate financing. In next month's *REF News and Views* we will discuss this in greater detail.