



Green Loans Series, Part 3 – Green Loan Principles in Real Estate Finance

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In our March edition of *REF News and Views*, we focused on the four core components to qualifying as a Green Loan Principles (“GLP”)-compliant green loan product. As a reminder, 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, with the four key components being:

- Use of proceeds
- Process for project evaluation and selection
- Management of proceeds
- Reporting

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 (the “Guidance”) to specifically address some of the more frequently asked questions on the application of the GLP in real estate financing.

What qualifies as a real estate green project?

There is no qualified market definition for the term “green projects.” It is therefore the responsibility of the market participants to agree to and clearly define the appropriate and applicable eligibility criteria for that green loan. The Guidance also recommends that this be documented carefully in the finance documents; in doing this, it could also help to mitigate accusations of “greenwashing.”

The Guidance provides useful details of retrofit projects that qualify as green projects. Ultimately, retrofit projects should result in a material improvement in the energy efficiency of the building/portfolio of buildings being funded. It should also result in a material reduction in the carbon emissions associated with that building/portfolio of buildings.

Evaluating the real estate green project

Most green loans used in real estate financing are to develop and invest in green buildings. Like a “green project,” however, there is yet to be a recognised market standard definition and classification for a “green building.” The Guidance therefore advises lenders to use external standards and certifications in order to measure the “greenness” of buildings, and it is recommended that the lenders detail such principles in the finance documents in order that the parameters are clear.

The Guidance also notes that lenders need to be wary that buildings which may be classified as green at the start of a loan term can cease to meet the requirements during the life of the loan. As such, it is prudent for the lenders to agree the methodologies and parameters for assessing the eligibility criteria not just on day one, but throughout the lifetime of the loan; such mechanisms can be addressed in the loan documentation. This also further extends to the principles mentioned above regarding segregating out the green loans from the non-green loans in order that such green loan proceeds can be appropriately tracked, together with its progress and application.

Reporting

The Guidance makes references to reporting, with recommendations that borrowers should aim to report at least annually on the use of the proceeds and on any material developments throughout. That said, it does recognise that such reporting requirements can depend on the size and nature of the transaction, project and borrower.

Closing thoughts on GLP

Whilst the GLP are ultimately voluntary, there are an increasing number of national and international measures and initiatives being discussed, created and imposed on corporate governance, climate change and sustainability that are starting to change how companies and the financial markets are operating and approaching their businesses.

With increasing socio-economic pressures, we fully expect to see a continued growth of green loans, as well as an evolution and development in the GLP over the coming years.