Episode 5 – Sustainability Linked Finance – Is it a flash in the pan?

Emma Part 1

Hello and welcome back to Addleshaw Goddard's series of podcasts on sustainable finance. You're listening to Emma Whitehall and Nick Parkin, part of AG's finance team. This is the final episode of the series, so if you've missed the earlier episodes then make sure you go over to AG's website, Spotify or Apple Podcasts to check those out.

Over the series, you've heard us talk about the benefits, processes and challenges around sustainability strategies and sustainability linked loans. Today we'll be talking about the future of sustainable finance. We all know that sustainability is very much a hot topic, both in the board room and at a national policy-making level, but is it a flash in the pan or is it here to stay?

In this episode we'll be hearing from Kate Lawlor, CEO of Bruntwood SciTech and Jayne Cottam, CFO at Assura, both of whom have been through the sustainability linked finance process and have well embedded sustainability strategies. We'll be talking to Radi Ivanova from Barclays and Vaughan Tyrell from HSBC, who will give a bank's perspective on the future of sustainable finance and Tim Claire, a director at sustainability consultancy Anthesis Group, will also be giving his thoughts.

Nick Part 1

With there being an increased focus on sustainability and ESG issues generally over the last few years, we wanted to find out where that motivation was coming from and if any external pressures played a part in steering the direction of thought. As you may have seen, earlier this year Addleshaw Goddard published the results of our sustainability research survey, where we spoke to over 1,000 business and finance leaders across the UK & Europe. According to that research, 92% of companies have felt more pressure to prioritise sustainability from banks than they have from media or social influences. We asked Kate Lawlor if Bruntwood had experienced pressures from the banks to proactively take steps to have a positive impact on ESG issues.

[So no I don't think we have been under a huge amount, well my experience over the last few months anyway is that we've not been under a huge amount of pressure from the banks themselves. Again, I think that comes down to the pool of banks that we were working with, some were more advanced in their thinking others weren't. So with not all of them on the same footing, you can sort of, it's not quite, it doesn't feel like you are being pushed in the same way I guess. I think probably the onus came from us ourselves more than anything having done the green loan activity previously, have seen the benefits from it, have seen what it's helped us to do in terms of shaping our sustainability strategy and also just then the perception in the wider market place about the fact that as more and more customers are beginning to think about the sustainability strategies and wanting their property providers to be thinking about sustainability, the fact that we can say that actually we're funded via a green loan or a sustainability linked loan, it sort of has a huge benefit in those discussions. So I think the pressure came more from us actually that we wanted to replicate something that we knew was really good, that we knew the market was moving in that direction anyway and there's such a greater emphasis being placed on it so I think probably the pressure came from us rather than the banks themselves. What I would say though is I think that's beginning to shift, even in that really short space of time that we've done ours which is only a few months ago now, it's almost as if those other banks that kind of were a little bit behind the curve are rapidly moving up the scale but I know the sustainability questionnaires coming out from banks now are asking questions around sort of what property investors sustainability strategies are and that's moved on in a really short space of time so I don't think it will be long actually before we actually get to a place where that pressure flips in the other direction.][1]

<u>Nick Part 2</u>

We also asked Jayne Cottam whether Assura had come under pressure from the banks.

[So to say under pressure would be a little unfair because as I said before it's a plan that we already had as a business. I've not had any pressure from banks, don't get me wrong they always come along and say would you like our sustainability linked RCF or would you like to have a look at a green bond etc., but I just see that as general product selling it's no different to what we've had in the past when we didn't have these initiatives. From our perspective, a lot of pressure would come from investors so shareholders. They expect a company to have this in there, you know, if you take ESG as a whole, you've got the environmental which we look at with our sustainability side and we have the social but we are generally a social business because we provide healthcare spaces and then the governance very much looking at the balance on diversity etc., within our organisation. That for us is where the pressure would be coming from if we weren't meeting and addressing either are there any issues or looking and signposting our direction of travel for our sustainability agenda rather than from any social media or anything else. However, we are also linked to the NHS and they've set their own sustainability and net zero agenda so we need to make sure we're working in sync with that, given they are our biggest customer.][2]

<u>Emma Part 2</u>

Both Bruntwood and Assura are ahead of the curve in terms of having implemented their sustainability strategies and obtaining sustainable finance, which is perhaps why they have not felt much pressure from the banks to do more. However, our research clearly shows that sustainability is a key area of focus for lenders and so having a well thought through sustainability assessment and plan is not something to put off. It will affect a business' access to funding and for many borrowers it will restrict their options when it comes to refinancing their existing facilities.

That said, most businesses have woken up to the fact that sustainability needs to be a key consideration in all aspects of business. We asked Jayne why sustainable finance in particular has been so important to Assura's sustainability strategy.

[With a business it makes you, dare I say, put your money where your mouth is, because it is very easy to spout off we'd like to do this and we'd like to do that and we'd like to do that and I think depending on the type of business you are, private or public etc., it probably varies who holds your feet to the fire the most and I think what the financing does is it helps back up everything that you're saying and shows that you know what when we say we want all our buildings at EPCB we're looking at a net zero carbon building for 2026 on one of our first developments, we want to be BREEAM excellent in everything we do and we will be measured against that and targeted against that and ultimately if it's on your RCF you could get penalised and pay a higher margin if you don't hit those targets then it shows that you're genuine and you actually mean what you're saying which I think is hugely important because I see some things and they just seem disingenuous and that's what we have to avoid because what that will do, if we have too many companies like that and businesses

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[1] Kate Lawlor – between 20.30 and 22.25 [3:04 – 3:45]

[2] Jayne Cottam – between 17:45 and 19.30 [3:49 – 5:12]

thinking ah well we'll just do this because we might save a bit of money or it looks good or whatever, then it really takes it away from those companies that are really you know this is the heart and soul of what they're doing as part of their business decision making processes.][3]

Nick Part 3

We also wanted to get a lender's perspective on why they think sustainable finance is a key aspect of a company's sustainability strategy. This is what Radi Ivanova at Barclays had to say.

[I think sustainable finance really sits at the core of national and international policy objectives. The framework that really has put corporate and financial institutions and governments under the spotlight of course are sustainable development goals which were launched in 2015 and I think now all these market participants are expected to demonstrate progress towards the achievement of these goals by 2030. Sustainability linked facilities are really an effective tool to do that.][4]

Nick Part 4

The number of sustainability linked loans has dramatically increased over the last few years. As we've heard from Alison Barry at HSBC in a previous episode, sustainability linked loans already account for a third of corporate loans in Europe.

We've heard throughout the series that businesses and finance providers are investing significant time and capital into sustainability, which is resulting in benefits such as greater access to funding, competitive advantage and excellent reputation and relationships with customers. We've discussed the fact that businesses may need to put themselves through a little bit of pain in order to implement and progress their sustainability strategies, so the obvious next question is whether sustainable finance is a flash in the pan or if it is here to stay.

Emma Part 3

[It's definitely not a flash in a pan and I think if anybody thinks it is or thinks it's just the latest sexy bit of financing I think ignore it at your peril because I think that you could potentially, if you wanted to take it on purely financial terms, end up with a divergence in pricing between standard financing sustainable or ESG finance whichever way you want to look at it, and I think if it does do that then it equally provides more of an incentive for companies to really think about this and get this on their agenda which ultimately is going to help us as a nation achieve you know the sustainable ambitions that we've got. It's almost an incentive if you will if you get a slight pricing advantage. It's definitely not a flash in a pan and it's the right thing to do and companies should be really taking this seriously.][5]

Emma Part 4

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[3] Jayne Cottam – between 19:30 and 21:10 [5:59 – 7:20]

[4] Radi Ivanova – between 22:25 and 23:10 [7:30 – 8:01]

[5] Jayne Cottam – between 22.00 and 23.10 [8:40 – 9:36]

Lenders are on the other side of the same coin when it comes to sustainable finance. We wanted to get the views of Vaughan at HSBC and Radi at Barclays, who are directly involved in the sustainable lending process. Firstly we heard from Vaughan.

[From a personal perspective I very much hope it is here to stay. There is a huge amount of work to be done in this area and vast investment required to meet the target set out in the Paris Agreement. These products are continually developing and have been designed to encourage borrowers to engage with the topic and set their own targets towards net zero. I am of course biased. However I believe sustainable finance is here to stay and will become a standard consideration in every transaction. The number of sustainability linked loans that are completed every year since their inception is continually increasing. They are an ideal product to give organisations the freedom to manage their finances as they see fit with no restriction on their use of proceeds. However they are able to benefit from margin reduction by taking actions to reduce their carbon footprint and making commitments to change. The business benefits, their employees and local communities benefit and ultimately the more organisations that engage with this, the more the world will benefit.][6]

<u>Emma Part 5</u>

This is what Radi had to say.

[I definitely think it is here to stay, purely looking at the pace of adoption of sustainable finance and the importance of sustainability considerations, I almost think sustainable finance will be the only type of finance in the future. Sustainability linked loans of course in terms of volumes have absolutely sky rocketed between 2017 and today and what has been really interesting to observe in the last 12 to18 months is the adoption of the sustainability linked product in the capital markets and also in the trade world. So now we see borrowers looking at their capital structure and trying to incorporate sustainability link considerations across the whole piece. So that definitely makes me think that from a borrower perspective the view is very much long term and this type of finance is here to stay and of course in the other part of the equation, investors and banks are increasingly required to report on their sustainability performance in terms of the investments that they make so the convergence of these two factors are definitely going to drive a long term view on sustainable finance.][7]

<u>Emma Part 6</u>

So it seems that lenders and borrowers are on the same page when it comes to the future of sustainable finance, but what do the advisors think? Tim Claire is a director at sustainability consultancy Anthesis Group and he had this to say.

[I think the obvious answer has got to be it's here to stay but it will become mainstream and mainstream from a variety of levels because this understanding of sustainable risk and sustainable opportunity will become, well it is very rapidly becoming central business thinking, it will become mainstream by virtue of the fact that when anyone is about to make a loan and they are going through the risks I think it will just become a standard element of you know along with wider assessments of the businesses rigidity and robustness etc. etc. sustainable factors will be in it so from that perspective I think it will be mainstream and I think what you might find is that some of the very

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[6] Vaughan Tyrell – between 29:45 and 30:45 [9:50 – 10:50]

[7] Radi Ivanova – between 25:45 and 27:05 [10:52 – 11:59]

bespoke sustainability products might end up being a flash in the pan because of this mainstream element, but then also I think you are going to have very specific areas you know particularly the really focused green investing etc.][8]

Nick Part 5

So there we have it folks, sustainable finance is here to stay. We all have a responsibility to behave in a sustainable way. Lenders are prioritising sustainability and by as early as 2025 plan to withdraw funding from businesses that aren't transitioning. Businesses must ensure that they are adapting, or they risk having greatly restricted and expensive funding options in the future. The thinking behind this is that businesses that have not assessed the risks and opportunities associated with sustainability will represent a higher medium term risk from a credit perspective.

The COVID-19 pandemic has provided a platform for businesses to re-evaluate. For many, that involves delving into their sustainability strategy and their sustainability linked finance options. Whilst there is some work to do upfront and there will be ongoing monitoring and reporting requirements, the broader economic, regulatory and investor drivers mean that sustainability linked loans are fast becoming the norm.

So, if there is one thing you should take away from listening to us throughout this series, it should be to act now or risk paying the price.

Emma Part 7

Thanks for tuning in to our sustainable finance series, we hope we have provided some useful insight into the world of sustainable finance and a huge thank you to our contributors throughout the series for providing their thoughts. If you'd like to discuss anything we've talked about in this episode or sustainable finance generally, please do not hesitate to get in touch with us, we'd love to talk to you and see how we can help. In the meantime, if you'd like to check out our research findings, head over to AG's website and search for the Sustainability Research Hub.

[8] Tim Claire – between 9.30 and 10.50 [12:13 – 13:19]