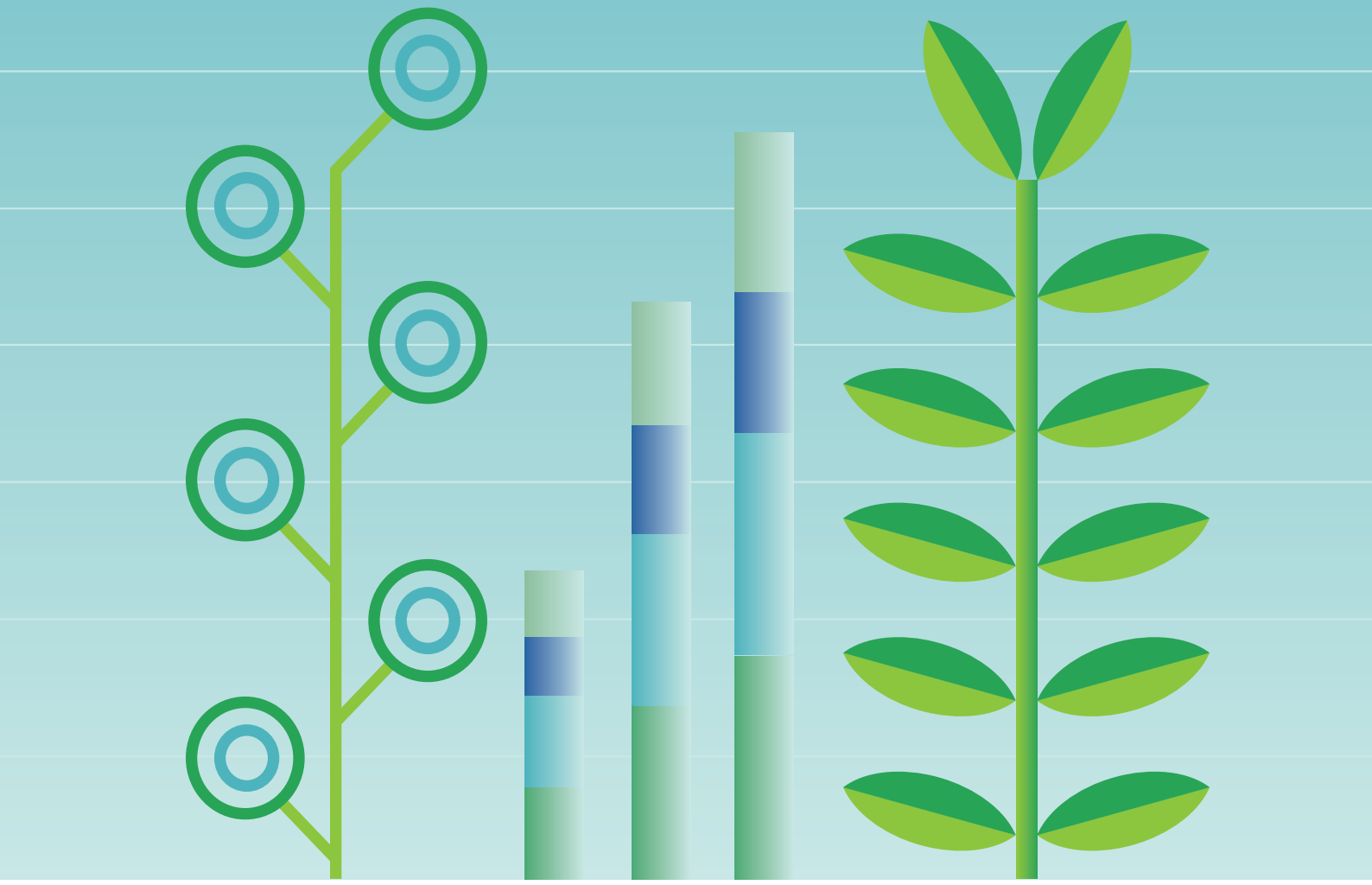
Green Loans
Australia & New Zealand



Climate Bonds INITIATIVE

Prepared by the Climate Bonds Initiative

ANZ MACQUARIE NZGIF NEW ZEALAND GREEN INVESTMENT FINANCE

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Introduction

Report Highlights

Australia and New Zealand are endowed with key ingredients to grow a green loan market

Significant boosts to supply of credit for green lending

Impetus to label loans from corporates demonstrating ESG credentials and accessing 'green' lending

Corporate benefits of labelled loans are broad

Global green loans and sustainability-linked loans have grown rapidly in the past two years. The Australia and New Zealand market is at early stages with potential for growth

Australia and New Zealand require significant investments in green infrastructure and assets to transition to a low carbon economy in line with their international commitments. The private sector, with one of the largest savings pools in the world as well as one of the largest bank balance sheets per capita, has the means to support public spending to provide the required funding. Sustainable finance will play an important role in transitioning economies to a low carbon basis and promoting social, financial and economic resilience for a future in line with environmental and societal objectives.

Both countries are endowed with favourable factors to significantly grow a climate/green labelled loan market:

- **corporate loan and residential mortgage markets are dominant forms of funding**, much larger than corporate bond markets;
- **financial markets are highly sophisticated**;
- **corporate sector is actively engaged in climate change** and transitioning to a net zero emissions economy;
- **developed and diversified green and sustainable finance sectors**; and
- **strongly growing ESG agenda** among local asset owners, asset managers, and banks.

Additionally, New Zealand's central government is pushing forward aggressively on decarbonising its economy and mandating climate risk disclosure.

What is a Green Loan?

Green loans are any type of loan instrument used to finance or re-finance projects, assets and activities with environmental benefits. Green loans are based on 'use of proceeds' (UoP) with borrowing proceeds transparently earmarked for eligible 'green' assets. It is global best practice for green loans to be arranged in line with the Green Loan Principles (GLP), the Climate Bonds Standard (to the extent of available criteria), as well as a number of country-specific guidelines.

Benefits of the green label

Benefits for borrowers include:

- Broaden the lender / investor base and offer new engagement opportunities
- Enhance external reputation and visibility
- Strengthen internal visibility of green issues e.g. with Board
- Build competitive advantage, demonstrate sector leadership and encourage better standards
- Support risk management and future proofing of the business

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About Climate Bonds Initiative

Climate Bonds Initiative is an investor focused not-for-profit, promoting investment in the low-carbon economy. Climate Bonds undertakes advocacy and outreach to inform and stimulate the market, provides policy models, market data and analysis, and administers the international Climate Bonds Standard and Certification Scheme. Climate Bonds' Green Bond Database is based on alignment with the Climate Bonds Taxonomy.

Climate Bonds Certification is a labelling scheme. Rigorous scientific criteria ensure that it is consistent with the 2˚C warming limit of the Paris Agreement. Certification requires initial and ongoing third-party verification to ensure the assets meet the metrics of Sector Criteria.

About this report

This paper covers the labelled green corporate loan market in Australia and New Zealand. It explores what has happened so far, best practice in labelling a green loan, and what should be done to channel loan markets for climate change investment. Additionally, we provide commentary on sustainability-linked loans and green consumer loans.

A growing Green corporate loan market

Early stage market seeing growth

The labelled corporate loan market in Australia and New Zealand has emerged in recent years and seen strong growth, with 14 labelled Green loans locally since the first ones in 2018.

The global labelled loan market has seen broadly two types emerge. 'Green loans' are proceeds based while 'Sustainability-linked loans' (SLL) are target or performance based (see box on page 10). Both types have developed, with the younger SLL exceeding Green loan volumes globally. This is in contrast to the more developed green, social and sustainability labelled bond market, where the vast majority of issuances have been on a 'use of proceeds' basis.

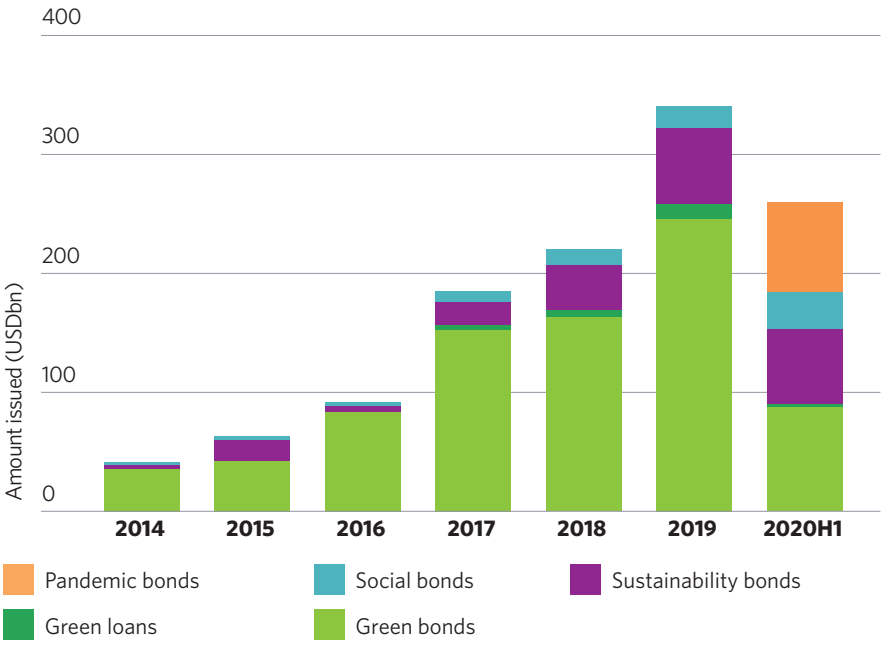
Loan market is larger, bonds leading the way on labelling

The loan market in Australia and New Zealand is much larger than the local bond market, yet far more green and other labelled bonds have been issued locally compared to labelled loans. Australia's loan market is over AUD 3 trillion compared to a domestic bond market of AUD 1.8 trillion, with non-financial corporate loans at AUD 1.0 trillion compared to bonds of AUD 240 billion.[1] New Zealand has NZD 150 billion of corporate loans.[2] Loans apply to a far wider group of corporate borrowers than can participate in green bonds.

The labelled bond market has led the way, in part, due to global precedent with larger volumes of labelled bonds globally, and earlier developments in market infrastructure such as global principles, than loans.

The local green loan market is at a similar nascent stage to the green bond market several years ago with a handful of early pioneer borrowers. Green and other labelled bond issuance in Australia has seen strong annual growth since the first ones in 2014, and from a diverse range of issuer types. This growth has largely been driven by strong investor demand for green products along with a number of contributing factors, such as improved understanding of green definitions, a common language among market participants, and simplicity, transparency and credibility of products. An increase in ESG awareness of issuers and ESG agendas of asset owners has also driven greater market activity. Green loans (and SLL) have similar ingredients to suggest potential for growth.

Global labelled bond and loan issuance rapid growth



Note: includes 'use of proceeds' bonds/loans only.

Significant boosts to supply of credit for green lending to support growth of green loans

Bank green lending targets, risk-adjusting of ESG factors by lenders, and strong stakeholder and institutional investor demand for green products all increase the supply of credit for green projects. This will lead to more competitive pricing from banks for green loans (labelled and unlabelled), to the benefit of borrowers. Early borrowers of green loans have been looking to tap into this growing pool of green credit, some supported by labelling.

The four major Australian and New Zealand banks have declared targets for green lending portfolios. These targets will boost credit supply for green loans and are expected to increase over time. The green lending criteria for some banks is regardless of product type, so can apply to either a green loan or SLL.

Investors and lenders are increasingly including environmental, social and governance factors in their credit assessments. This is typically at the corporate level of the borrower. Some banks, particularly in Europe, are risk-adjusting for ESG factors in determining pricing. This will increase demand of labelled (and unlabelled) structures issued by companies demonstrating their ESG credentials.

Banks globally are keen to tap into strong institutional investor demand for green bonds with their own issuances. Some banks will prioritise green loans (both labelled and unlabelled) as they seek eligible assets to earmark against the issue of their own green bonds. This will lead to increased allocation of credit for green loans. Furthermore, some institutional investors, such as large superannuation funds, are increasingly looking to invest directly into green loans.

> "New Zealand continues to work towards an effective transition to a low carbon economy. We are delighted to support this ambition, and we see the growth of the labelled loan within the green finance market as an important development toward meeting our climate goals."
>
> **Jason Patrick**, Chief Investment Officer, New Zealand Green Investment Finance

Corporates provide impetus to label loans

Corporates seeking to demonstrate their ESG credentials through sustainable finance markets are, in part, driving demand for labelling of green loans. These loans are complementing their ESG agenda, which are often driven by increasing stakeholder demands, particularly from shareholders, consumers and the wider community. As investors have driven demand for growth in green bonds, so corporates are providing impetus for green loans.

Labelling to support access to new lenders and/or loan markets is also a driver for some borrowers, particularly as pools of green funding are increasing in different parts of the world. The green label can provide lenders with surety over the 'green' credentials of the loan, more so where a new lender does not have a close relationship with the borrower.

Strong expertise to guide labelling can sustain growth and reduce reputational risks. Banks have supported the growth of the broader sustainable finance markets in Australia and New Zealand, through their own balance sheet, with both issuances and lending, as well as underwriting and arranging labelled bonds and loans for clients. The local banking sector boasts strong credentials in sustainable finance compared to its global peers with deep expertise, diverse product offerings, a high level of best practice, and a strong appetite to enable and drive customer ESG ambitions. The local advisory ecosystem of second party opinion providers, verifiers and lawyers is also developing well.

"Transition pathways are critical for companies from high-emitting sectors if Australia and New Zealand are to meet their international climate obligations. Support from markets and institutional investors, increased adoption of green bonds, loan and sustainability-linked finance can play a significant role in accelerating the decarbonisation of hard-to-abate sectors."

Didier Van Not, General Manager, Corporate & Institutional Banking, Westpac Institutional Bank

Development of Principles and Guidelines

Principles for both green loans and sustainability-linked loans have been published in the past couple of years to support the development of both these markets. The **Green Loan Principles** (GLP) were published in March 2018 by the Loan Markets Association (LMA), together with the Asia Pacific Loan Market Association (APLMA) and the Loan Syndications and Trading Association (LSTA).[3] The **Sustainability Linked Loan Principles** (SLLP) were issued in March 2019, similarly by LMA, together with APLMA and LSTA.[4]

The GLP and SLLP were both developed by a working party, consisting of representatives from leading financial institutions active in the sustainable lending market, with the support of the International Capital Market Association (ICMA).

Some national and regional institutions have also provided guidelines and taxonomies for sustainable finance, for example the People's Republic of China, the European Union (see box below) and Japan. Several other countries are expressing interest in sustainable finance taxonomies.

Green loans impacting

Green loans can shift corporate behaviour, improve risk management and future proof business. Green loans (and bonds) can encourage corporate prioritisation of green projects and assets over non-green ones. Green loans for many borrowers accelerate an internal push to integrate green into the borrowers' other investment strategy as well as internal corporate strategy. This internal cultural shift arises as wider areas of the business, especially treasury, through the labelling of green loans become more educated about the green agenda and more supportive as they see associated business benefits.

As climate risks translate into financial risks, companies, particularly those with a low level of integration, must start preparing and managing these risks in a structured manner to protect both revenues and reputation. Green loans and bonds are well understood, transparent instruments, that can help to fund this transition and catalyse this process.

Loans support a broader development spectrum of green projects compared to bonds. Green loans can be used as direct financing in developmental stages of new green projects and assets, with greater capacity to absorb higher project development risk and with flexibility over cash drawdowns. This is distinct from bonds, which are largely refinancing tools for developed projects. An active green loan market enables green projects to access critical early stage finance, which can be refinanced at more developed stages into a longer-term bond or loan.

EU taxonomy on sustainable finance

The Taxonomy Regulation, effective since July 2020, will require large companies, issuers of securities and financial market participants in the EU to analyse their economic activities and report publicly on the extent to which they are 'sustainable' as defined by the EU Taxonomy.[5] It is intended for phased application in 2021-22. The reach of these regulations is expected to be further than the EU and have flow through effects for Australia and New Zealand. For example, European banks will be disclosing their global lending of green and sustainable products according to the EU Taxonomy. For green loans, this means to be disclosed as such (by a European lender), they will need to comply with the EU Taxonomy, i.e. loan proceeds can only be directed to 'eligible' assets.

More sectors and enterprises can access sustainable finance markets with green loans, as certain sectors and companies have limited access to the bond market due to the scale typically required to enter that market. To date most green bond issuance have been from sovereigns, financial institutions, and large scale property and energy companies. Most assets underpinning these green bonds are from energy, transport and buildings sectors. While energy and buildings are also key sectors for green loans, other sectors, such as transport, agriculture and waste, are well placed to access the loan market.

Local labelled green loans emerge in past two years

There have been 14 labelled green corporate loans in Australia, from ten borrowers, and two in New Zealand. Of these, nine are Certified under the Climate Bonds Standard. All the green loans since the publication of GLP in 2018 have been in line with those principles and supported by a second party opinion. In this paper we focus on loans that are labelled publicly as 'green' or similar, although we note that loans have been used to finance green projects such as renewable energy for decades without being labelled as such.

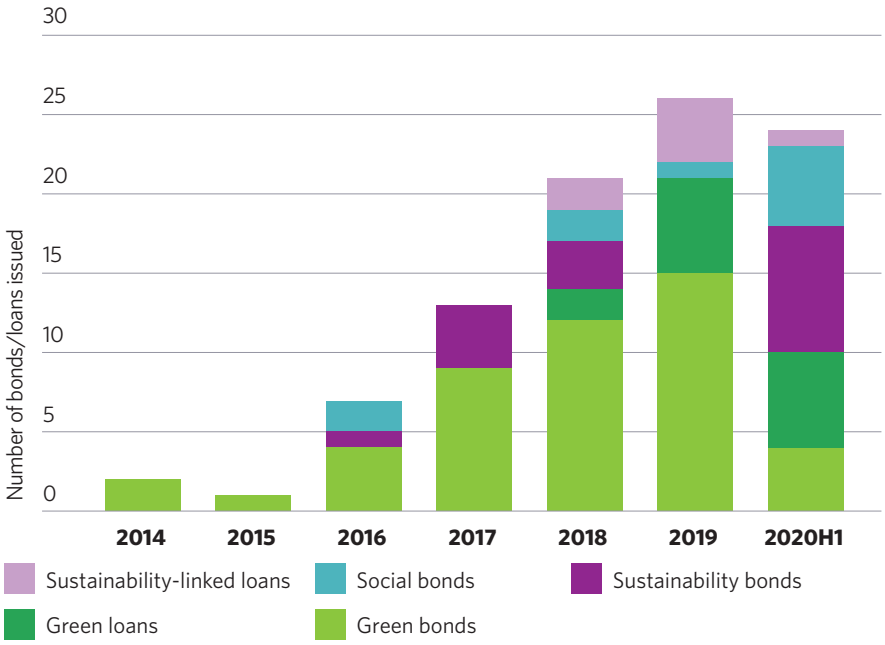
Australasia's first green loan was agreed in August 2017 by **Contact Energy**, a New Zealand power utility. A world first certification of an entire 'Green Borrowing Programme' was launched to fund existing and future geothermal power generation assets, certified under the Geothermal Criteria of the Climate Bonds Standard. The programme included existing and future debt, with eligible debt at the time amounting to NZD 1.8 billion (USD 1.4 billion). Certifying an entire programme provides flexibility to Contact Energy, allowing it to refinance and raise new debt at any time, using a variety of debt instruments.

Macquarie Group agreed Australia's first labelled green loan in June 2018 as a borrower, a GBP 500 million green tranches of a loan facility. The loan is the first globally by a financial institution under the GLP, which was published in March 2018. The green tranches are used to support renewable energy projects, and energy efficiency, waste management, green buildings and clean transportation projects in the future. In March 2020, Macquarie Group also agreed a USD 150 million **green tranche of a Samurai loan facility** under the GLP, the first green loan made by an Australian financial institution into the Japanese market.

Global Case Study: Calpine USD 1.1 billion Green Loan

Calpine Corporation agreed a USD 1.1 billion Climate Bonds Certified green financing on 10 June 2020 against geothermal power plants at the Geysers, which is the largest such complex in the US and provides almost one-tenth of the annual renewable power for California.[6] The syndicated financing consists of a USD 900 million senior unsecured green loan and a USD 200 million letter of credit facility. The green loan bears interest at 2.00% per annum, increasing by 0.125% every three years, maturing in 2027.

Australian labelled loan recent growth



Investa Commercial Property Fund (ICPF) agreed Australia's first Certified green loan under the Climate Bonds Standard and the GLP in January 2019, a AUD 170 million bilateral loan with ANZ, where proceeds are used for eligible property assets. ICPF has since made a series of green bilateral loans of AUD 100 million with HSBC in late 2019, and AUD 100 million each with CBA, Westpac and NAB in 2020. All these green loans are Certified under the Climate Bonds Standard. ICPF's entire property portfolio of AUD 5.1 billion has been reviewed as eligible assets under the Climate Bonds Standard to support green loan or bond certification.

Frasers Property Australia, a subsidiary of a Singapore-based group, secured a syndicated green loan for AUD 600 million for a five-year term refinancing in March 2019 under the GLP. The green loan has a reducing pricing structure with interest cost savings from the second year onwards if the borrower's five-star Global Real Estate Sustainability Benchmark ratings are maintained.

In June 2019, **Brookfield Properties** agreed a AUD 880 million, five-year, Certified green loan to refinance existing debt relating to Brookfield Place Perth Tower 1 and 2, the largest single asset syndicated green loan in Australia.

Elliot Green Power engaged a green loan facility, with AUD 260 million drawn in July 2019, to finance three new solar projects in Australia, Certified under the Climate Bonds Standard.

Genex Power agreed a AUD 192 million 20-year green loan facility in December 2019 to finance 50MW Jemalong Solar Project and refinance its existing debt facility for the 50MW Kidston Solar One Project. The senior loan tranche (AUD 175 million) is Certified under the Climate Bonds Standard.

> "Green and sustainability-linked loans are the next stage in financing to help companies promote their environmental, social and governance strategies. These emerging loan formats are part of an expanding suite of financing mechanisms to drive investment decision making and capital allocation around building low carbon and sustainable infrastructure, business practices and operating models."
>
> **Christina Tonkin**, Managing Director, Corporate Finance, ANZ

The first green loan for Australia's superannuation sector was agreed in March 2020 by Local Government Property Fund, managed by **Local Government Super** (LGS) for AUD 65 million. The loan was Certified under the Climate Bonds Standard under its Buildings Criteria. LGS has received a 5-Star Green Star Performance rating from the Green Building Council of Australia for its entire property portfolio.

In July 2020, **Salt Lake Potash** agreed a green loan to develop its fertilisation production at its Lake Way project. The loan follows the GLP, verified by a second party opinion.

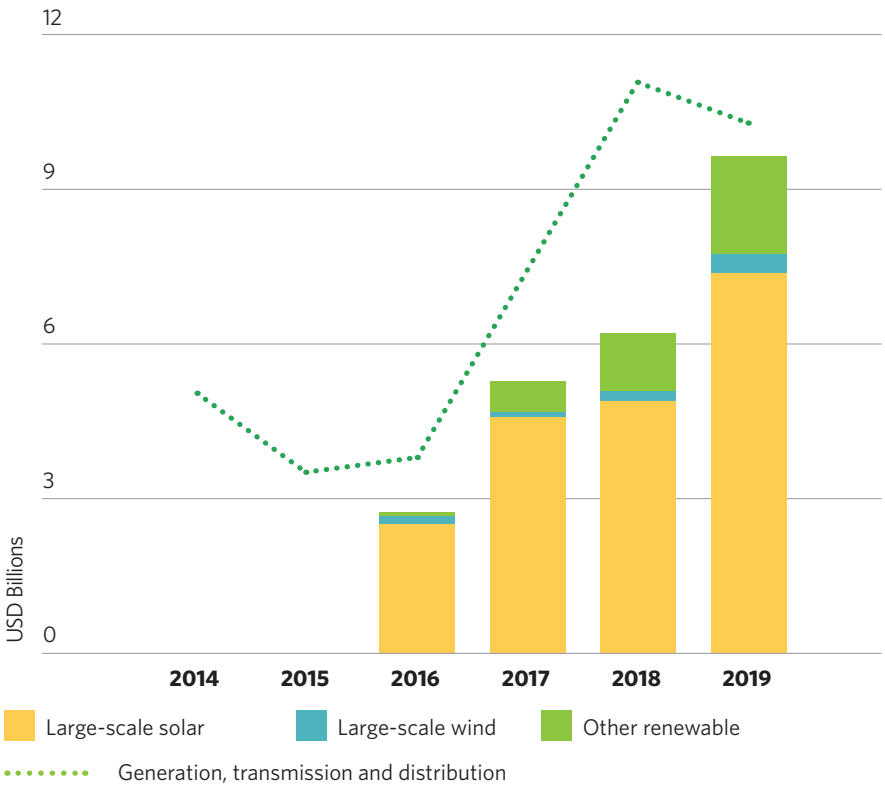
The latest Australian green loan in August 2020 is a financing of the stage two, development to construction, of **Murra Warra II** wind farm in Victoria. The first project finance green loan to a wind farm in Australia follows the GLP, supported by a second party opinion, and was to a consortium of six international bank lenders.

In August 2020, **Meridian Energy**, a New Zealand electricity generator of fully renewable energy, green labelled its entire debt of NZD 1.8 billion (comprising bonds and loans). Its wind assets are allocated to existing retail bonds and a smaller credit facility, all Certified under the Climate Bonds Standard's Wind Criteria. Its hydro assets are allocated to its other bonds and loans, which are aligned to the GBP and GLP supported by a second party opinion.

Loans without any specific label or designation have been used to finance green projects for decades. As both Australia and New Zealand grow their green project pipeline to meet their international climate commitments, all green loans, labelled or not, will increase. There are estimated to be over 100 loans to green projects in Australia, aggregating over AUD 12 billion of outstanding amounts, largely consisting of project loans to solar and wind farms. Similarly in New Zealand there are numerous loans to green projects without labelling. For example, CentrePort Wellington recently agreed a green credit facility with New Zealand Green Investment Finance (NZGIF) to fund low carbon projects. As with the early days of the green bond market, unlabelled loans significantly outnumber labelled green loans, and can be expected to continue to do so for some time while green loans become established as a wider market and asset class.

Green loans have featured in labelled asset-backed securities (ABS) in Australia. Flexi Group has issued Certified green tranches in four ABS to refinance solar consumer loans. NAB Trust Services vehicle issued AUD 200 million Certified green notes, backed by a pool of loans to finance wind and large-scale solar projects. Pepper Group has securitised mortgage loans in three green RMBS deals and National RMBS Trust in one. In September 2020, Brighte Capital announced Australia's first 100% Green Certified ABS, comprising unsecured green Certified loans to households for residential solar and battery installations.

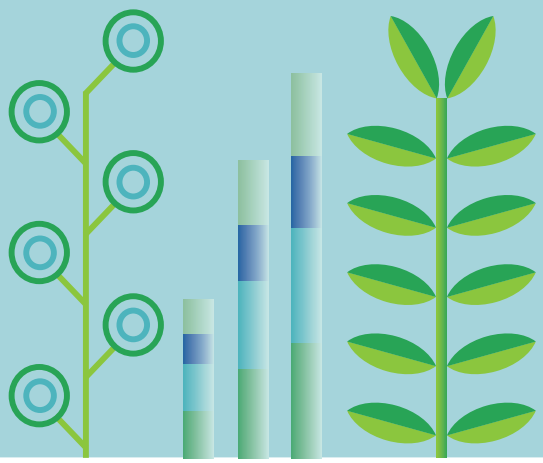
Energy sector show huge potential for green loan growth[7]



National Sustainable Finance Initiatives

The Australian Sustainable Finance Initiative (ASFI) was established in 2019 and the New Zealand Sustainable Finance Forum (SFF) in the same year. Both set out to align the finance sector to support greater social, environmental and economic outcomes for their respective countries. They bring together leaders from banks, superannuation funds, insurance companies, financial sector peak bodies, NGOs and academia with the aim of developing a Sustainable Finance Roadmap.

The roadmaps will recommend policies and frameworks to enable the financial services sector to contribute more systematically to the transition to a more resilient and sustainable economy. They are intended to be consistent with global goals such as the UN Sustainable Development Goals and the Paris Agreement on climate change. The ASFI and SFF roadmaps will be launched in 2020/21.



How to label a green loan

Who can enter into a green loan?

Any entity which has suitable green assets to finance can enter into a green loan. The key aspect of green finance is that the borrower commits to investing the funds borrowed in green assets. These include renewable power generation, low carbon transport, low carbon buildings, sustainable water management, sustainable waste management, sustainable land use and/or climate change adaptation or resilience measures such as flood defences. An overview of the Climate Bonds Taxonomy of sectors is provided on page 13.

1 Develop a green loan framework

- Define eligibility criteria for projects/assets
- Create selection process
- Set up tracking & reporting

The first step for any private or public sector entity looking to finance a green project and enter into a green loan is to develop a green investment strategy and define a Framework laying out the selection process and eligibility criteria for identifying the projects to be financed.

The entity needs to define procedures for the tracking and reporting of allocated and unallocated funds. Further, a greater trend in impact reporting means it is advisable to identify suitable metrics and initiate a monitoring and reporting process.

Is there guidance available?

When pursuing green loans, the Green Loan Principles (GLP) published by LMA and APLMA provide useful guidance on four key aspects:

1. setting eligibility criteria,

2. asset / project screening,

3. management of proceeds and

4. post-issuance reporting.

The Climate Bonds Taxonomy builds upon the GLP and provides definitions for asset and project types compliant with the Paris Agreement, i.e. decarbonisation by 2050 and limiting global warming to 2˚C.

Country and regional specific guidelines and frameworks should also be taken into account.

2 Best practice: Arrange an external review

External reviews

External reviews from an independent party, which confirm alignment with Green Loan Principles and/or compliance with the Climate Bonds Standard, have become common practice. The most common forms of review are:

- **Assurance report:** an external party confirmation of compliance with GLP.
- **Second Party Opinion:** an external assessment of the issuer's green loan/ bond framework, confirming GLP compliance and analysing the 'greenness' of eligible categories.
- **Green rating:** an evaluation of the green bond or related framework against a third-party rating methodology, which considers the environmental aspects of the investments. These include products developed by international and domestic rating agencies, e.g. Moody's, S&P.
- **Verification reports for Certified Climate Loans:** third party verification, pre- and post-issuance, which confirms that the loan adheres to the Climate Bonds Standard and Sector Criteria.

A Certified Climate Loan confirms that the loan is aligned to the Paris Agreement and to keeping global warming under 2°C.

In order to receive a Certified Climate Loan, a prospective borrower must appoint a Climate Bonds' Approved Verifier, who will assess the assets and issue a verification report to confirm that the loan meets the Climate Bonds Standard. Certification of a loan prior to closing enables the borrower to use the Climate Bonds Certification Mark in the loan marketing efforts. After the loan has been agreed and allocation of the loan proceeds has begun, the borrower must confirm the Certification by obtaining a post agreement verification report at least once to maintain its Certified status. The borrower must report annually while the loan is outstanding.

3 Execute the loan

4 Post-execution reporting

Report annually to confirm that the funds are allocated to green projects / assets

Best practice: Disclose environmental impacts of financed projects in absolute terms and relative to an appropriate benchmark

Labelling of green consumer loans expanding

Green consumer loan products have expanded in Australia and New Zealand in recent years as lenders have sought to provide differentiated products to meet consumer demand for climate supportive borrowings, some with preferential pricing. These have largely been self-labelled by lenders, in contrast to labelled corporate green loans that are typically done so by borrowers. While there are currently no global or local principles for labelling of green consumer loans, as with GLP for corporate loans, there are established local ratings schemes for mortgages, such as for example NatHERS and Green Star, and some loans have been verified as eligible assets under the Climate Bonds Standard.

Need to develop a green home loan market locally

Our homes are an essential part of our lives, they are also major contributors to carbon emissions, with homes in Australia contributing 13% of the nation's total. A 2019 New Zealand study found the need to shrink the carbon footprint of their homes by 80% for the country to meet its international climate commitments. There are 9 million existing homes in Australia, and 1.8 million in New Zealand, many of them built below current building code regulations, hence an integral part of driving net zero outcomes requires energy efficiency improvements to existing homes. New homes energy efficiency is important too, as by 2050 at least half of all homes in Australia will have been constructed after 2019.

In Australia, mortgages are valued at AUD1.82 trillion[9] and in New Zealand this is valued at NZD272 billion.[10] Australian banks have amongst the highest proportion of residential mortgage assets in the developed world [insert any comparable stats].[11] The risk to the finance sector is significant. Most home loan contracts are in place for up to 30 years, a timeframe during which climate risk exposure will become more pronounced.

Governments and some banks locally have been exploring the use of green home loans to drive energy efficiency improvements in the residential sector for some time, however only a couple of initiatives have come through.

Introduced in April 2019, **ANZ 'Heathy Home Loan Package'** in New Zealand offers home loan interest rate discounts to customers who build their home or property to 'good sustainable standards'.[12] The available discounts include 0.7 per cent off the standard fixed home loan rate and 1 per cent off the standard variable home loan rate, in addition to fee waivers across a range of accounts. These options are offered to houses that are built or upgraded to achieve a rating of 6 or more stars against the New Zealand Green Building Council's 'Homestar' rating tool, which is independently verified.

In August 2019, CBA offered existing mortgagees a AUD 500 cash back offer for having installed, or having the intention to install, a solar system with an output size of equal to or greater than five kilowatts. The green home loans are verified as eligible assets under the Climate Bonds Standard.

The **Bank Australia Clean Energy Home Loan** was launched in January 2020, drawing on up to AUD 60 million in finance from the **Clean Energy Finance Corporation** (CEFC). The Bank Australia Clean Energy Home Loan features a range of discounts starting at 0.4 per cent per annum over a maximum of five years, for new homes and for energy efficient upgrades to existing homes.[13] The current loan program has had early success with the AUD 60 million of origination now projected to be completed within nine months, well ahead of the original projection of 18 months.

Banks such as, for example, Bendigo Bank, Regional Australia Bank and Hunter United Employee Credit Union in Australia, and ANZ in New Zealand, provide lower interest loans when customers commit to undertaking energy and water efficiency home improvements such as installing solar, double glazed windows, external awnings or rainwater tanks.[14]

While we have covered labelled green residential mortgage loans, there are numerous cases of unlabelled loans and other forms of funding to support energy efficient homes. Green mortgages though can and should take a leading role in transforming the residential market by creating conditions for new and existing homes to move towards a net zero carbon future.

"As a committed investor in the development of Australia's green bond market and now in the emerging green loan market, the CEFC welcomes the continuing development of labelled loan products. We see significant potential for the development of new green loan investment products across corporate, residential and consumer markets to satisfy growing demand from investors for sustainable investment options. These markets and products must be robust, ambitious and transparent to maintain integrity and growth potential."

Richard Lovell, Executive Director Investment, Clean Energy Finance Corporation

Personal green loans

There are different types of green consumer loans in the Australian and New Zealand markets, offered by a range of lenders from credit unions to online lenders and international banks. These loans provide a range of customer incentives such as interest rate discounts and fee waivers. Different types of equipment currently qualify for these green consumer loans, the most common being electric vehicles, rooftop solar panels and batteries, as well as water tanks.

International models to scale green mortgages

Internationally, different finance approaches have been used to drive the uptake of green mortgages to support energy efficient homes, or to fund home efficiency improvement upgrades.

In the United States, the **Federal Housing Administration** (FHA), an agency which insures mortgages of approved lenders meeting specific requirements, has had in place the Energy Efficient Mortgage program since 1980. This program allows home-owners to access finance for efficiency upgrades by providing insurance for the additional funds sought.[15] Under this arrangement, the mortgagee is able to access enough finance for the principle loan and additional funds which must be directed towards energy efficiency upgrades. In this case, their principle loan is assessed by the financial institution and the additional funds are insured by the FHA in case of a default. This is in recognition that energy efficient homes have reduced utility bills and therefore will have lower ongoing costs, thus are lower risk investments because they reduce the financial burden on home-owners.

The **European Energy Efficient Mortgages Initiative** (EeMAP) was launched as a pilot involving 37 banks in 2017. The intent of the EeMAP initiative is to create a standardised 'energy efficient mortgage' based on a private bank financing mechanism with preferential interest rates for energy efficient homes and/or additional funds for retrofitting homes at the time of purchase.[16] This initiative seeks to bring together the Capital Market Union and energy efficiency goals by using mortgage and bond industries to ease the initial financial burden of efficiency upgrades to home mortgage holders.

Fannie Mae Green Financing is the most important program of its kind around the world, particularly with large scale and ease of accessibility. Fannie Mae is also the world's largest green bond issuer, with over USD 75 billion in green mortgage backed securities. They have accessed debt capital markets through their Green Financing Business to offer multi-unit buildings and cooperatives finance to upgrade for water and energy efficiency, focussing on sectors of affordable housing, retirement living and the build to rent sector. The uptake in their green loan products has been facilitated by their ability to purchase and guarantee favourable loans of houses and apartment blocks where there is a commitment to energy and water actions.[17] A unique feature of the program is its approach to rental properties, where they have integrated consideration of additional lending to a tenant's saving in utility bills. This allows an owner to take out a larger loan, while ensuring improvements made through the loan benefit the tenants financially.

Lenders under the program are able to provide their customers with lower interest rates, the ability to borrow more and underwritten cash flow based on projected energy and water savings. One criticism of the program is that these hurdles are not sufficiently ambitious. In the medium term, these will need to be made more ambitious to target net-zero emissions by 2050.

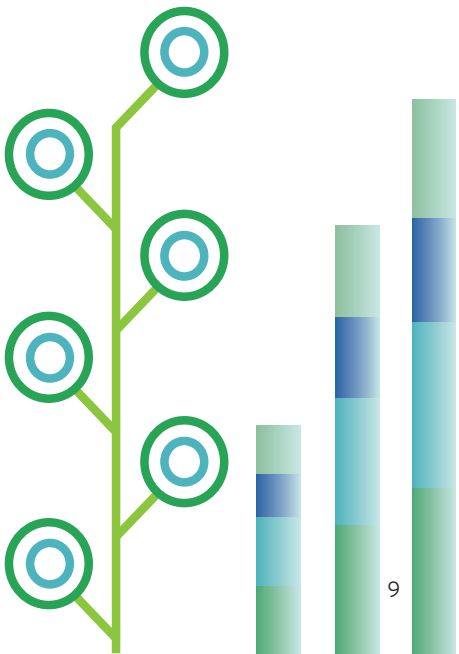
Green guidelines for consumer loans

The Climate Bonds Sector Criteria can be applied to consumer loans as guidance for determining green labelling. The proceeds of the loan must be matched with 'eligible' assets that meet the available Sector Criteria, in a similar manner to corporate loans. While the consumer loans are not certified as such, they can be verified as qualifying under the Climate Bonds Standards by lenders.

The Building Criteria has been applied in Australia for green home loans, for homes with solar panels in all States except Western Australia. Location specific Criteria for Residential Buildings, the Australian residential rooftop solar proxies for the Certification of houses or apartments using solar rooftop installations was published in 2019. The Criteria proxy looks at variables such as type of residential building (house or apartment), size of the building (number of bedrooms), presence of natural gas supply, presence of a swimming pool, the location within Australia (postcode, and hence climate zone and solar intensity), as well as the installed capacity of any rooftop solar system (kW).

The Low Carbon Transport criteria can be applied to consumer loans for electric vehicles. Fully electric or hydrogen fueled passenger vehicles are automatically eligible within the criteria. Hybrid fossil fuel / electric passenger vehicles are eligible above certain CO_2 emissions thresholds.

In the absence of globally recognised principles for green consumer loans, the Climate Bonds Standards provide lenders of consumer loans with credible guidelines in certain sectors. The lenders can in turn use the consumer loans as qualifying assets to match against their own green bond issuances, that would be eligible for Climate Bonds Certification.



Sustainability-linked loans emerging

The rapid rise in the global SLL market has been extraordinary in its first couple of years. In 2019, the SLL market was over USD150 billion globally, which is nearly half of the 2019 issuance amount of the more established green, social and sustainability bonds, and significantly larger than green loan activity. This growth has been driven by the flexibility of the instrument and the nature of the loan market where a closer relationship between lenders and borrowers enables lenders to have more ability to provide incentives for ESG/sustainability performance and to absorb a variation in the margin on a loan.

European market leads growth with more than 80% of global SLL activity, with activity focussed mostly on Spain, France and Italy. Many of the larger transactions outside of this region have been for subsidiaries of European companies that have entered into SLL in their own right already. The United States has seen only a handful of borrowers of SLL. Asia has seen activity largely in Singapore with some in Hong Kong and China. Australia has seen five, and New Zealand two, SLL to date.

The emergence of SLL provides an asset class with broader application. SLL are a welcome development of the sustainable finance markets. They provide a financial tool to suit certain borrowers and work well in the bank lending markets. The instrument provides an opportunity for borrowers to demonstrate their sustainability ambitions and promote positive change. Borrowers can align financing costs with their sustainability agenda, which in turn enhances internal support and dialogues for changing corporate behaviour.

SLL can apply to a wider range of borrowers than for green loans or bonds, which are limited to those that have eligible green assets. The instrument is also used by borrowers that have eligible assets or have green loans, such as for example Contact Energy, as it provides another financing tool to demonstrate their ESG credentials and connect with stakeholders.

The benefits for borrowers are typically beyond pricing, as with green loans. The variation of the interest margin on most SLL in Australia and New Zealand is between 5 to 15 bps (i.e. 2.5 to 7.5bps in either direction). With a very low interest rate environment, low credit margins for large corporates and a competitive lending market the scope for margin variations is limited.

A new paradigm for impact

Assessing the impact of an SLL is different to that of a Green loan. With SLL, there is greater emphasis on the corporate level sustainability strategy, as well as on improvement of sustainability performance over time. This improvement is rewarded with an interest margin benefit on the loan, and, conversely, worsening performance can lead to a higher interest cost. With green loans, the emphasis is more on the size of the borrowings and the nature of the financed or earmarked eligible asset, particularly with regard to its environmental impacts. While the two instruments are different, both can and are assessed for their impact on sustainability and/or environmental goals, which should be material, measurable and credible (see box on climate transition).

Goals relating to climate should be aligned to Paris agreement objectives of 1.5 / 2° C, with clear quantitative transition trajectories to net zero by 2050. Whereas, social and broader sustainability targets can look to the United Nations Sustainable Development Goals as a useful starting point for assessing their global impact.

While not current market practice, partly due to the private nature of loan markets, it is our view that greater public disclosure and transparency of SLL targets and performance parameters along with external verification in line with established principles will support longer term growth of this asset class.

Increasing supply of credit for green also apply to SLL

As previously discussed, bank lending targets, ESG risk adjusting, lender ESG impact reporting and investor demand for green products are increasing supply of credit for green lending. This largely applies for SLL too, and will support growth of this market.

The strong demand from institutional investors in labelled bonds may not translate to the SLL market, in the same manner as for green loans. SLL are typically not eligible assets to be matched against a labelled bond issuance.[18] This is unlikely to be a material factor in the current market, as other aforementioned factors are expected to grow the supply of credit for SLL.

"The progress we've seen to date in the emerging green loan market in Australia and New Zealand can be attributed to transparency between issuers and investors and robust certification, as well as the diversity of issuers and product offering. We look forward to further innovation in sustainability-linked loans to help increase investor confidence in the environmental impact issuers are making and to maintain growth in this developing market."

Stuart Green, Group Treasurer, Macquarie Group

What is a Sustainability-Linked Loan?

Sustainability-linked loans (SLL) are a type of loan instrument which incentivise the borrower's achievement of ambitious, predetermined sustainability performance objectives. These loans are 'target based' or 'performance based' where the interest margin on the loan varies depending on the borrower's performance against predetermined environmental, social and/or governance (ESG) targets. Such parameters are usually set at an entity level, and can be at or above the borrower's own ESG targets. It is global best practice for SLLs to be arranged in line with the Sustainability Linked Loans Principles (SLLP). There is no constraint on the use of proceeds, they are typically used for general corporate purposes.

Sustainability Linked Loan Principles

The SLLP set out the core characteristics of a SLL based on the following four core components:

1. Relationship to Borrower's Overall Sustainability Strategy (material to the business)

2. Target Setting – Measuring the Sustainability of the Borrower

3. Reporting

4. Review

Early shoots of local activity

Five companies have borrowed in Australia with SLL, and two in New Zealand, of which Contact Energy also has a green loan.

Adelaide Airport agreed Australia's first SLL in December 2018, a 7-year AUD 50 million bilateral loan. The margin varies depending on the borrower's performance against a set of ESG criteria.

Sydney Airport borrowed the largest SLL in Asia-Pacific and the largest globally for an airport, with a AUD 1,400 million syndicated loan in May 2019. The loan was agreed in three tranches with maturities from 3-5 years. While not an SLL, Sydney Airport issued in February 2020 a AUD 100 million **sustainability linked bond** into the US Private Placement market with a two-way variable margin, the first such bond globally.

In July 2019, **Queensland Airport** Limited borrowed for its Gold Coast Airport development, a AUD 100 million bilateral SLL.

AGL agreed a AUD 600 million SLL in September 2019, becoming the first energy company to do so in the Asia Pacific region. The SLL has two KPI metrics, one relating to emissions intensity and the other to renewable energy and storage capacity.

Wesfarmers entered the latest SLL with a AUD 400 million bilateral in March 2020. The loan is linked to progress on environmental and social targets, the former relating to carbon emissions relating to the production of ammonium nitrate.

New Zealand has seen two SLL so far. The first by **Synlait** in September 2019, a 4-year NZD 50m bilateral credit facility. The second by **Contact Energy** in January 2020, also a 4-year NZD 50m bilateral loan.

Global Case Study: Sustainability-Linked Loan

In July 2020, Norwegian shipping group Klaveness Combination Carriers (KCC) agreed a sustainability-linked term loan and revolving credit facility for the financing of vessels with delivery in 2021. The credit margin on the loans will be adjusted, up or down, based on the company's sustainability performance with reference to its goal of reducing CO2 emissions per ton of transported cargo per nautical mile (EEOI) and reducing absolute CO2 emissions per vessel. The company wide target is to be carbon neutral by 2030. KCC's sustainability performance/KPIs will be disclosed on a quarterly basis and main KPIs will be subject to an annual external audit.

Global Case Study: Enel USD 1.5 billion Sustainability-Linked Bond

The Italian energy group Enel issued a USD1.5 billion five-year bond with a 2.650% coupon for general corporate purposes.[19] This rate is subject to the company's strategy of having at least 55% of its installed capacity in renewable energy sources by 2021. If this goal is not reached by 31 December 2021, the coupon will be increased by 25bps until the bond matures.

Climate Transition

SLL can be an important tool for companies in 'high emission' or 'hard-to-abate' sectors to transition to low carbon basis

While SLL can have much broader application than for climate change, the instrument can work well for companies that are in transition to a low carbon basis regardless of whether they have suitable assets to earmark against a green loan (or bond). This is particularly relevant for companies transitioning in high emissions or hard-to-abate sectors where investors are increasingly seeking sustainability labels to demonstrate a wider strategic shift within the company, whereas green bonds linked to single green assets might not be ambitious enough. Lenders too are increasingly seeking to work with their customers in these sectors to encourage and assist with transition.

Sustainability-linked loans (or bonds) can be used as an important tool to demonstrate wider strategic changes as long as the targets are transparent, ambitious and credible.

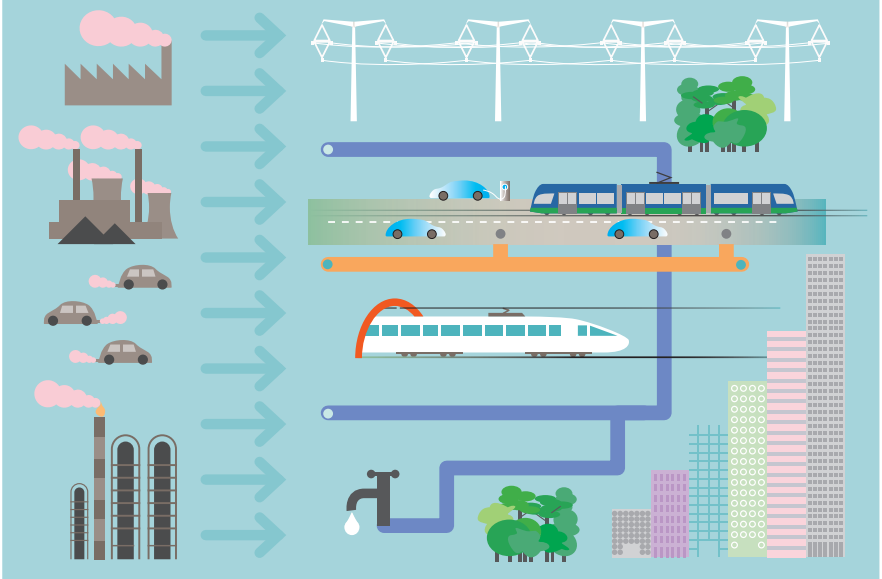
Principles for climate transition finance

Climate Bonds Initiative has produced a report, 'Financing credible transitions',[20] that provide key principles on climate transition. These may be useful for SLL, and include the following:

- **In line with a 1.5°C global trajectory** – all goals and pathways need to align with zero carbon by 2050 and nearly halving emissions by 2030.
- **Established by science** – all goals and pathways must be led by scientific experts and are not entity - or country-specific.
- **Action not pledges** – a credible transition is backed by operating metrics that a pathway is being followed rather than a commitment/pledge to follow a transition pathway at some point in the future. In other words, this is not a transition to a transition.

Implications for climate-related SLL

For investors to understand targets, they need to be transparent and clearly demonstrate what actions the company is committed to taking to improve performance against a KPI and how these relate to a broader global climate transition.



Actions to catalyse growth

The green loan (and SLL) market in Australia and New Zealand is poised for growth. Here are five actions that can support, and accelerate, its development.

1. Regulators can tilt the playing field towards green

Regulators could incentivise green lending by recognising that loans made to fund green assets are less exposed to climate risks, thereby requiring less capital for these loans. Central banks and regulators can also ask banks and insurers to disclose the climate riskiness of their balance sheets identifying green and brown assets. Increasingly central banks are asking supervised banks to undertake stress tests, to recommended scenarios to see how loans perform under high carbon prices, or physical climate change impacts like higher temperatures or sea-levels.[21] We would also like to see regulators and supervisors exclude the use of assets with high climate risks from their collateral framework, or their use in asset purchase programmes.

In Hungary, the central bank has undertaken analysis to confirming that energy efficient homes are less liable to become delinquent. It has reduced the capital adequacy requirement for pools of green mortgages to sufficiently energy efficient homes, and has asked banks to transfer some of this benefit to borrowers by reducing interest rates by 0.3%.[22]

There are also opportunities for government and regulators to make use of fiscal incentives to encourage green loans. For instance, the tax authorities could provide certified green loans funding green investment to benefit from accelerated depreciation allowances to reduce early year's tax liability. This is particularly important for green loans which are often applied to future costs (as opposed to green bonds which are frequently used for re-financing completed projects). The German government's stimulus package includes tax incentives for energy-efficient retrofits and low-emission vehicles, further incentivising the latter with a EUR 6,000 "eco-bonus" for EV purchase.[23]

2. Tap into strong institutional demand for green products to expand investor base

Institutional investors are showing strong demand for green products, and have driven the growth in green bonds. They are potentially a meaningful pool of investors for green loans and SLL, which to date have mainly been invested in by banks. In the US, private placements are a notable portion of the debt market where US institutional investors invest directly into non listed debt instruments. Australian and New Zealand issuers of green debt, such as Contact Energy and Monash University, have issued into the USPP market.

As both confidence and scale increases, so too will opportunities for direct investing by institutional investors. This will include green loans as well as SLL. This variety of opportunities is important given that some institutional investors may be less comfortable with the coupon variation of SLLs, as pricing of these can be challenging and transferability can be important.

Local institutional investors are at early stages of allocating funds into direct lending with high profile announcements in the past year. This is expected to grow and will support greater lending capacity for green loans and SLL.

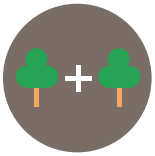
3. More corporate frameworks and ESG strategies required

Many companies are not geared to set up long term ESG strategies, targets, and green asset identification and 'tagging' processes that are needed in order to enter into a green loan or SLL.

Some companies are increasing their capacity to identify, record and disclose climate risks and ESG performance as their shareholders, customers, suppliers, regulators and other stakeholders demand more information. TCFD requirements will accelerate this process. This change will lead to more companies with the ability and frameworks to issue green loans and SLLs.

Similarly, greater information technology capabilities to record green assets are required to expand 'tagging' of larger volumes.

4. Education, education!



The sustainable finance market is fast changing with new regulations and guidelines, new products and labels, market practices, and investor expectations. The complexity too is growing. New issuers, borrowers, investors and lenders have a steep learning curve to understand the products and process. The supporting ecosystem of bankers, lawyers, verifiers and regulators need to be up to date with the latest developments. This all requires education of the market actors at a rate that keeps up with the pace of this market.

5. Widening of labels, Narrowing of language

The loan market, as well as bond, has seen an expansion of labels in recent years with several different themed financial instruments developing. Loans with a purpose, whether social, environmental, governance or other, have been largely welcomed by investors, whose demand for such instruments have underpinned the growth of this market. The various labelling of these loans requires education and clarity to market participants. A clarity of labelling along with a narrowing of language with a common understanding of these labels will help in growing a labelled loans market. In May 2020, ICMA published high level definitions of sustainable finance, including green, social and sustainable finance.[24] This will support a common understanding and usage of language as the sustainable finance market develops.

Conclusion

Green and sustainable finance is growing and changing rapidly, with green loans playing a major part in this growth. Local and global developments will shape this market in the coming years and ultimately support growth. The local sustainable finance initiatives, ASFI and NZSFF, will announce their Roadmaps later this year. The EU Green Taxonomy will come into effect on a voluntary basis, with implications expected to extend much further afield than the EU. Green loan markets are poised for growth in the coming decade as lenders and borrowers cooperate and leverage market development to support local economies to transition to become net zero and climate resilient.

Climate Bonds Taxonomy

The Climate Bonds Taxonomy identifies the assets and projects needed to deliver a low carbon economy and gives GHG emissions screening criteria consistent with the 2-degree global warming target set by the COP 21 Paris Agreement. More information is available at https://www.climatebonds.net/standard/taxonomy.

ENERGY	TRANSPORT	WATER	BUILDINGS	LAND USE & MARINE RESOURCES	INDUSTRY	WASTE	ICT
Solar	Private transport	Water monitoring	Residential	Agriculture	Cement production	Preparation	Broadband networks
Wind	Public passenger transport	Water storage	Commercial	Commercial Forestry	Steel, iron & aluminium production	Reuse	Telecommuting software and service
Geothermal	Freight rail	Water treatment	Products & systems for efficiency	Ecosystem conservation & restoration	Glass production	Recycling	Data hubs
Bioenergy	Aviation	Water distribution	Urban development	Fisheries & aquaculture	Chemical production	Biological treatment	Power management
Hydropower	Water-borne	Flood defence		Supply chain management	Fuel production	Waste to energy	
Marine Renewables		Nature-based solutions				Landfill	
Transmission & distribution						Radioactive waste management	
Storage							
Nuclear							

Certification Criteria approved
Criteria under development
Due to commence

06/2020

Endnotes

1. https://www.rba.gov.au/statistics/tables/
2. https://www.rbnz.govt.nz/statistics/s31-banks-assets-loans-by-purpose
3. https://www.lma.eu.com/application/files/9115/4452/5458/741_LM_Green_Loan_Principles_Booklet_V8.pdf
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17. https://www.environmental-finance.com/content/the-green-bond-hub/bringing-billions-and-housing-to-the-green-bond-market.html
18. Green, social and sustainability bonds are UoP based under relevant global principles. Sustainability-linked bonds (SLB) are not UoP based, however, they are typically based on ESG targets and performance of the issuer rather than any SLL that the issuer might be holding. ICMA published the Sustainability Linked Bond Principles in June 2020 providing voluntary guidance to SLB issuers.
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24. https://www.icmagroup.org/assets/documents/Regulatory/Green-Bonds/Sustainable-Finance-High-Level-Definitions-May-2020-110520v4.pdf

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Source data is from the Climate Bonds Green Bond Database as well as Thomson Reuters Eikon. All figures are rounded.

About the sponsors

ANZ

ANZ is a leading sustainable financier in Asia Pacific, assisting customers to shift to a net-zero carbon economy.

The bank was sole financier to CleanPeak Energy Renewable Investment and CleanPeak Energy for a portfolio of behind-the-meter roof-top solar and battery projects, the first financing of its kind in Australia.

CleanPeak Energy Renewable Investment is a JV between First Sentier Investors, formerly Colonial First State Global Asset Management, and CleanPeak Energy.

In Asia, ANZ was sole Underwriter and Joint Green Structuring Adviser to SK Innovation's US$450 million green loan. A unit of South Korean conglomerate SK Group, SK Innovation will use the loan proceeds to invest in an US-based electric vehicle battery plant as part of the company's shift towards a low-carbon economy.

ANZ introduced a new A$50 billion commitment by 2025 to fund and facilitate sustainable solutions for customers including initiatives to help improve environmental sustainability, increase access to affordable housing and promote financial wellbeing.

New Zealand Green Investment Finance

New Zealand Green Investment Finance (NZGIF) is a green investment bank established by the Crown to accelerate investment that reduces greenhouse gas emissions in New Zealand. Set up with initial capital of $100 million, NZGIF is an independent limited liability company. It deploys capital with other investors on a commercial basis, in companies and projects that accelerate emissions reductions. With a broad mandate and ability to invest flexibly, NZGIF can invest across the capital structure, execute transactions and mitigate risks for its partners. NZGIF makes independent investment decisions, informed by a Board and a senior executive team with expertise in banking, financial markets, impact and green investment.

Macquarie Group

As the No. 1 global renewables financial adviser and leading developer of green energy assets, Macquarie is supporting the transition to a greener economy. With expertise across energy infrastructure, solar, wind, waste to energy, biogas and other specialist sectors, Macquarie has invested in or arranged $A9.0 billion in green projects in FY20.

Macquarie's capability in this sector has been further enhanced by the Group's 2017 acquisition of the Green Investment Group (GIG), bringing a depth and breadth of global expertise in green technology and development to create a powerful platform supporting principal investments and the next phase of expansion in renewable energy.

Macquarie Group has agreed a number of green loans that support renewable energy projects such as wind and solar farms, and energy efficiency, waste management, green buildings and clean transportation projects.

Westpac

Westpac is Australia's first bank and oldest company, serving over 14 million customers. We have a long history of sustainability leadership and have been recognised as a global banking sector leader in the Dow Jones Sustainability Index since 1999.

We are the largest financier to greenfield renewable energy projects in Australia over the past three years, funding 13 projects with capacity to support more than 1.2 million households.

We actively finance solutions and technology that accelerate the transition to a low carbon economy, and have increased our total committed exposure to climate change solutions to $9.7 billion, progressing towards our 2020 target of $10 billion; and facilitated $4.5 billion in funding for climate change solutions, exceeding our 2020 target of $3 billion.

We have played a prominent role in developing the AUD green bond market since facilitating its opening with World Bank's 2014 green issue. In New Zealand, we remain the only bank to have issued a green bond. In 2020, Westpac partnered with Local Government Super to structure the first green loan in the superannuation sector.

Author: Haran Siva

Contributors: Prashant Vaze, Bridget Boulle, Elham Monavari

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