Capsticks

ESG and Sustainable Finance

ESG Sustainability Frameworks

A key part of a sustainability strategy for a business is choosing which ESG reporting standards or ESG framework to report against. Once a business has decided what ESG metrics it wants to set for itself it then needs to benchmark those metrics against a standard or framework. There are a variety of different frameworks available.

The United Nations Sustainable Development Goals

The United Nations Sustainable Development Goals (often referred to as the UN SDGs) are a series of 17 goals set by the UN which are a global call to action with the aim of ensuring peace and prosperity for people and the planet, now and into the future. The SDGs cover aims such as sustainable cities and communities, no poverty, gender equality, affordable and clean energy etc. Mapping your sustainability strategy to the UN SGDs is a good starting point for a company beginning their sustainability journey.

Sustainability Reporting Standard for UK Social Housing (SRS)

In the social housing sector housing providers can report against the Sustainability Reporting Standard for UK Social Housing (SRS). The SRS comprises a series of criteria for registered providers to report against across 12 core themes including climate change, resource management, placemaking, resident voice and building safety.

GRESB

In the real estate sector GRESB (formerly named the Global Real Estate Sustainability Benchmark) is used. The GRESB Real Estate Assessment offers both a real estate and a development benchmark, which include components covering management, portfolio performance and development activities.

IFRS S1 and S2

The International Sustainability Standards Board issued IFRS S1 and IFRS S2 in 2023. These standards are intended to be the first globally applicable ESG reporting standards.

IFRS S1 requires an entity to disclose information in its financial statements about all sustainability-related risks and opportunities that could reasonably be expected to affect the entity's cash flows, access to finance or cost of capital over the short, medium or long term. Sustainability-related risks and opportunities that could not reasonably be expected to affect an entity's prospects are outside the scope of the standard.

IFRS S2 requires an entity to disclose climate related risks and opportunities.

The UK government is committed to applying IFRS S1 and S2 to UK businesses but has not, as of yet, indicated when this will be coming into force and the types of entity it will initially apply to. It is likely that public limited companies will need to report against IFRS S1 and S2 initially with the scope being broadened in due course.

The FCA will be consulting on the implementation of IFRS S1 and IFRS S2 in the UK in summer 2024.

WHAT KIND OF SUSTAINABLE FINANCE IS AVAILABLE?

Green Loans

Green loans have to be drafted in accordance with the LMA Green Loan Principles and have four key criteria:

1. **Use of Proceeds**
   The proceeds of a green loan must be used for a green purpose. So a company entering into a green loan must use the loan proceeds to finance a project with environmentally friendly aims (i.e. investing in retro-fit or climate adaptation activities, investing in renewables or building green buildings).

2. **Process of project evaluation/selection**
   The borrower seeking to enter into a green loan needs to be able to demonstrate to the investor:
   - how they have selected the green project
   - what "green" certifications or kitemarks the project has or the may be looking to obtain
   - how they have determined that the project will remain a green project for the life of the loan.

3. **Management of Proceeds**
   Loan proceeds under a green loan must be held either in a locked account or otherwise held in a transparent way so that the proceeds can always be identified.

4. **Reporting**
   The borrower has to report against an agreed set of ESG related performance indicators on an annual basis. ESG performance will need to be verified by an external party (either an auditor or a Second Party Opinion Provider who will provide an independent assessment of the accuracy and integrity of a loan or framework that is used for strategic decision making by investors).

Sustainability Linked Loans

Sustainability linked loans (SLLs) have to be drafted in accordance with the LMA (Loan Market Association) Sustainability Linked Loan Principles.

The proceeds under an SLL do not have to be used for a green purpose but instead can be used for general working capital purposes. Sustainability linked loans incentivise sustainability performance by linking the margin under the SLL to annual ESG metrics and sustainability performance targets set by the borrower. These metrics have to be science based, material to the core sustainability and business strategy of the borrower and go beyond business as usual.

If the borrower under an SLL meets its metrics then the margin under the facility will decrease. If the borrower doesn't meet its metrics then the margin under the facility will increase. Note that in the affordable housing and healthcare sectors it is usual for there to be a one way margin ratchet only (the margin under the loan will not increase if the metrics are not met).

The metrics under an SLL must demonstrate (on behalf of the company) a pre-existing and meaningful commitment to ESG. Third party verification (annually) of the company's progress against the ESG metrics and specific performance targets they have set is required.

Social Bonds

Social bonds are issued in the capital markets and have to be issued in accordance with the ICMA (International Capital Markets Association) Social Bond Principles.

The proceeds of a social bond must be used for an eligible social project. The definition of "Social Project" in the Social Bond Principles is wide and includes: affordable housing, infrastructure and food security. Social bonds can therefore be used to fund the building of social housing and placemaking, building strong inclusive communities that people want to live in.

Issuers of a social bond will usually have a sustainability framework which has been drafted in accordance with the ICMA Social Bond Principles. A legal opinion on that framework (provided by a Second Party Opinion Provider) will be required by the bond investors who will also require annual sign off of the metrics underpinning the social project.

Green Bonds

Green bonds are issued in the capital markets and have to be issued in accordance with the ICMA Green Bond Principles. The same four criteria discussed earlier in connection with green loans equally apply to green bonds. Again a legal opinion provided by a Second Party Opinion Provider will be required by the investors along with annual sign off of the metrics underpinning the green project being financed by the bond.

HOW CAPSTICKS CAN HELP

Capsticks are ESG and green, social and sustainable finance specialists. Whether you're an ESG expert or starting your sustainability journey we can help. We can advise on green and social loans or bonds, green private placements and sustainability linked loans. We can provide bespoke training on various aspects of ESG. We can also assist you with putting in place a sustainability strategy or a sustainable framework, drafting ESG policies and advise on net zero transition plans and ESG/impact reporting.

To learn more about ESG, see our resource here.

CONTACT

NAOMI ROPER
PARTNER
0774 132 4623
naomi.roper@capsticks.com