#FORSustainability

Guidance Note – Green Lending & Certificate of Title Considerations

WHAT IS GREEN LENDING?

With continued emphasis on the importance of sustainability, lenders and borrowers are faced with increasing pressure to provide financial services and projects that address Environmental, Social and Governance (ESG) issues. As a result, lenders and the wider financial market have seen the emergence and growth of two types of loans, green loans and sustainability linked loans ("SLLs").

Green loans and SLLs are both terms coined to describe financial instruments framed to promote environmental sustainability. Whilst it is not uncommon to see both these terms referred to as "green loans", they differ in terms of purpose and key characteristics.

Green loans are specifically tied to funding projects with clear environmental/social benefit. The borrower will need to demonstrate how the funds will be used towards a predefined green initiative and throughout the term of the loan meet pre-set key performance indicators and reporting requirements.

SLLs on the other hand can be used for general corporate purposes where the lender incentivises the borrower to improve their sustainability performance. In the real estate space, SLLs are used for real estate financings because property assets have an environmental impact and can easily be measured against benchmarks, such as BREEAM, EPC ratings, NABERS etc. Lenders can tie interest rate arrangements to the borrower's achievement of

sustainability targets, for example increasing renewable energy usage or reducing greenhouse gas emissions.

HOW IS THE MARKET STANDARD EVOLVING?

The green loan and SLL market is rapidly developing and offers a broad spectrum of opportunity for those seeking to lend and borrow on greener terms. Some criticism from the market surrounds the lack of standardisation and the loan markets have responded by publishing a set of principles setting out a framework (produced by a working party including the Loan Market Association) for both SLLs (originally launched in 2019, with the latest update in February 2023) and green loans (originally launched in 2018, with the latest update in February 2023) (see this link here to these resources). The principles and supporting guidance set out the core components one would typically expect to see.

This is just the start. Many in the market anticipate lenders becoming increasingly concerned with sustainability (for example, in ensuring compliance with minimum energy efficiency letting requirements) which could ultimately be a key determining factor for credit approval as well as lenders expanding the range of green loans and SLLs that are available. With the transition to net-zero in years to come, it is imperative asset managers adapt, tapping into greener financing options to strengthen the value of their properties.

WHAT TRENDS ARE LAWYERS SEEING IN RELATION TO SUCH "GREEN LENDING"?

- Specific representations included in the facility agreement around maintaining certain environmental ratings (such as EPC ratings or achieving BREEAM excellent (in respect of a development loan)).

- Interest rates linked to sustainability targets.
- Pre-specified payment requirements included in the facility agreement whereby the borrower must contribute the associated savings (e.g. monies saved as a result of benefitting from a lower interest rate) to wider ESG initiatives.
- Sustainability/Green Coordinator - this is a new role within the facility. Their role involves identifying suitable key performance indicators with the borrower and often leading negotiations during the lifetime of the loan in respect of green clauses.
- Greater focus in the legal due diligence report (Certificate of Title (as discussed below)) on assessing the current environmental performance of the asset.

WHAT IS A CERTIFICATE OF TITLE ("COT")?

This is an industry standard form of property due diligence report, which is drafted by the City of London Law Society. This type of report is most commonly used in financing transactions and sets out what is considered the standard terms for an institutionally acceptable headlease and occupational lease as well as other points in respect of the property. The certifier (who is a lawyer) will then confirm whether any terms of the leases or other matters they are reviewing deviate from the standard position set out in the CoT. Additionally, the lawyer will report on the title rights and covenants and the searches undertaken in respect of the property.

WHY IS THE DRAFTING OF THE CERTIFICATE OF TITLE RELEVANT IN RESPECT OF ESG CONSIDERATIONS FOR A PROPERTY?

We are seeing a steady increase in lending arrangements being put in place that have some element of sustainability or broader ESG requirements (often known as sustainability linked loans or lending).

Additionally, landlords and tenants are becoming more creative with the terms they are including in their leases in order to match certain internal ESG targets that their respective businesses have set.

The details in the CoT will highlight the various legal terms included in leases as well as factual points about the property. As mentioned above, SLLs or ESG linked loans often achieve this link to non-economic factors by including a set of key performance indicators (KPIs). The CoT can provide a useful reference for lenders to assess the baseline from which KPIs are framed.

Additionally in respect of environmental factors, the CoT could also flag climate change risks within a real estate asset. For example, does the lease allow for the landlord to obtain access to the premises to undertake energy efficiency improvement works without tenant consent?

Can the landlord recover some or all of the costs of such works through the service charge?

CERTIFICATE OF TITLE PROVISIONS

The current CoT excludes from the remit of the report any climate change risks. Additionally, there is no section of the CoT that lists out the common green lease provisions which are being included in some occupational leases. In May 2023 when the most recent eighth edition of the CoT was issued, the view of the committee was that too few leases include green lease provisions and so they are not yet the "standard". Including statements on green lease provisions would create extra work for certifiers by requiring additional disclosures. However, the committee acknowledged that their position may change in the future and the guidance for the eighth edition CoT does refer to green lease provisions being disclosed in the final "Other Material Matters" section of the CoT relating to occupational leases.

The updated eighth edition CoT does include statements relating to:

- The landlord and tenant will share data relating to the environmental performance of the property, subject to keeping the data confidential. This is now a common lease provision in leases (even those without any other significant green lease provisions).
- EPCs:
    - A disclosure to confirm the rating and the date of expiry of the EPC.
    - The extent of the property that is covered by the EPC and to provide details for all EPCs covering the property.
    - A confirmation is required that the EPC has been registered on the statutory register.
- The tenant may not carry out any alterations which adversely affect the energy performance certificate rating for the property.

GUIDANCE NOTE – GREEN LENDING & CERTIFICATE OF TITLE CONSIDERATIONS

WHAT SHOULD BORROWERS AND LENDERS AGREEING SUSTAINABILITY OR ESG LINKED LENDING ARRANGEMENTS CONSIDER IN RESPECT OF THE COT?

The CoT will not expressly prompt the reporting lawyers to include every term which relates to the legal provisions around ESG credentials of the property.

As will usually be the case, the borrower may need to procure a specialist environmental survey of the property and that report can be appended to the CoT.

In reviewing a CoT, the lender may want to double check that the certifiers of the CoT have included any relevant provisions relating to sustainability or other ESG provisions (as there are no specific statements for them). For example:

- green lease provisions and requesting detail on whether compared to the market the provisions are considered particularly "pale green" (relatively high level on sustainability) or "dark green" (more detailed and stringent on sustainability);
- provisions relating to social initiatives that the landlord or tenant has included in the lease, such as using local or ethically sourced providers to a building or participating in estate management initiatives such as consolidated waste management or proactive delivery traffic management;
- unacceptable assignee provisions to prevent assignment of either the lease or its reversion to a party that has disreputable connection; or
- specific modern slavery provisions which go beyond the standard "comply with all laws" provisions in leases.

Additionally, if a landlord has introduced a placemaking/community initiative at an estate, this could include a set of shorter-term leases or licences with socially trading organisations (often local, small start ups or not-for-profit initiatives) who are granted leases on different terms from the market standard. These lease provisions, which include shorter lease terms, limited or no repairing obligations, more flexible break rights and profit-share or turnover rents, will not fit into the standard market statements provided for by a CoT, and as a result lots of disclosures will need to be made. As such, a discussion with the lender ahead of the CoT being drafted may allow for another form of lease report to be agreed which will save the legal teams time in reviewing and reporting on these types of arrangements.

For further ideas on potential climate related disclosures that could be included in a CoT, **the Chancery Lane Project**, Tomas's Clause, includes a disclosure checklist of items to consider.

(Please note that the checklist was drafted for the previous seventh edition of the CoT published in 2012 and updated in 2016, but the eighth edition has not made significant changes to the CoT form and so many of the comments remain applicable to the eighth edition CoT.)

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