



April 2019

FINANCING A MORE SUSTAINABLE FUTURE PART II – Tailoring loan agreements

As discussed in our [January 2019](#) briefing, there has been growing awareness of the importance of sustainable finance as part of a multipronged approach to tackling climate change. In a recent [economic letter](#) issued by Professor Philip R. Lane, Governor of the Central Bank of Ireland, Professor Lane described the challenges, along with the potential opportunities, for the Irish financial system as a result of the threat of climate change, whilst also recognising the role that the Central Bank has in ensuring financial firms incorporate climate change into their strategic and financial plans. This poses the question as to how can we prepare our loan documentation appropriately for the green loan product. As previously stated, a green loan is any type of loan instrument made available exclusively to finance or refinance, in whole or in part new or existing green projects. Green loans should be aligned with the Green Loan Principles (the [GLP](#)).

The GLP provide a useful starting point when considering how loan documentation needs to be appropriately developed. The GLP offers a framework of market standards and recommended guidelines which are a useful benchmark for the green loan market. The following are the four key components of the GLP:

1. Use of proceeds.
2. Process for project evaluation and selection.
3. Management of proceeds.
4. Reporting.

To incorporate these four key components of the GLP in loan documentation, the following is a brief overview of some of the pertinent clauses to be considered:

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1. **Purpose:** the purpose clause should be drafted such that it is clearly articulated that the loan proceeds are to be utilised for green activities or Green Projects (as defined in the GLP and listed at Appendix 1 of the GLP) or for a purpose that is consistent with the first GLP principle - Use of Proceeds. The GLP recognize several broad categories of eligibility for Green Projects. As such the definitions of green and green projects may vary depending on the sector and geography.

As a condition precedent to the initial utilisation of the green loan facility, the lender and borrower should agree on:

- a) the process and parameters by which the borrower will determine how its project fits within the eligibility categories set out in Appendix 1 of the GLP;
- b) the sustainability targets and criteria (the **Sustainability Criteria**) for testing the use of the loan proceeds, which will be based on external assessment standards (or ratings);
- c) the process for project evaluation. In order to evaluate the performance of the project against the Sustainability Criteria this will require the certification or verification by a third party expert (the **Green Project Monitor**); and
- d) the frequency of evaluations by the Green Project Monitor (e.g. whether it is monthly, quarterly, annually or more frequently).

As a further condition precedent, the Green Project Monitor should provide a detailed report confirming the borrower's compliance with the Sustainability Criteria, with further updated reports to be provided by the Green Project Monitor as a condition to subsequent utilisations.

2. **Accounts:** the account provisions should be drafted such that it is clear that the proceeds of the green loans are to be credited to a separate, designated, green loan account. In circumstances where the green loan forms part of a series of tranches in a loan facility, the proceeds of the green loan should be credited to a segregated account.
3. **Margin:** the margin for the loan(s) may be adjusted accordingly such that it may be increased or decreased depending on the borrower's performance against the Sustainability Criteria. The GLP recommend the use of both qualitative and quantitative performance measures to communicate the expected impact of Green Projects. Some of the common criteria assessed include the impact of the Green Project on the environment, energy use, health and safety record, transparency and governance.
4. **Drawdown mechanics:** the borrower may only be allowed to draw new funds once the Lender has received satisfactory confirmation from the Green Project Monitor.
5. **Representations:** the representations in the loan agreement should be augmented to include sustainability-related borrower representations. These may be tested in the same way as financial covenants, and failure to meet those criteria may trigger defaults, giving lenders the usual acceleration rights.

6. **Sustainability Undertakings:** sustainability covenants may include, but are not limited to, the following:
 - a) ensuring the practical completion of the Green Project;
 - b) ensuring that the completion of the Green Project is in compliance with all applicable environmental, social and planning laws, regulations or otherwise;
 - c) ensuring that the required sustainability certification (e.g. BREEAM / LEED) is obtained;
 - d) ensuring that the borrower does not do or omit to do anything which could result in the Green Project failing to satisfy the Sustainability Criteria; and
 - e) meeting other specified key performance indicators.
7. **Information Undertakings:** the borrower should be obliged to provide the lender with ongoing updates (the frequency of which is to be determined by the lender and borrower) on the use of the loan proceeds, until the loan is fully drawn and as necessary after that point in the event of any material developments. The Lender will also require ongoing reporting obligations by the Green Project Monitor as a condition precedent to subsequent drawdowns.
8. **Compliance Certificate:** the borrower should provide a compliance certificate as a condition precedent to subsequent utilisations of the loan facility and as a part of any periodic testing and/or information requirements, wherein they confirm, inter alia, testing the Sustainability Criteria. This is a similar approach to that adopted in the testing of financial covenants.

Ultimately, the changes to be incorporated in a loan agreement are to be applied on a deal-by-deal basis depending on the underlying characteristics of the transaction and the potential risks involved. The above is not an exhaustive list of changes that could be made to loan agreements.

How can Dillon Eustace help?

If you have any queries in respect of the above or require further information, please contact your usual Dillon Eustace contact or any member of the Banking and Capital Markets Team.

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