Money Does Grow on Trees for Hotel Developers

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The emergence of "green financing" in the hospitality and leisure sector stands to benefit not just the environment but hotel developers too.

Environmental, social and governance (ESG) investing has grown to prominence as the corporate sector seeks to positively contribute to reducing the impact of climate change. As a result, financing of corporate projects now includes mechanisms such as "sustainability-linked loans" (SLLs).

SLLs incentivise a borrower to carry on business in a climate-conscious way, with the operation of the loan pegged to the sustainability performance of a borrower. If a borrower meets or exceeds its sustainability targets as agreed to by the lender, they will benefit from, for example, a reduction in interest rates. Conversely, if a borrower fails to meet its targets, it may suffer from higher interest rates or a reduction in financing availability.

A suite of resources has been created to assist parties, including The Asian Pacific Loan Market Association's (APLMA), Loan Market Association's (LMA) and Loan Syndications & Trading Association's (LSTA) recently released guidance documents.

The main takeaway from the guidance? Borrowers need to work with lenders to build sustainability targets that are independently verified, certified and measurable, to ensure compliance with the SLL principles:

- **Selection of key performance indicators (KPIs)** – These are used to assess the sustainability performance of the borrower, by reference to the sustainability performance targets (SPTs).
- **Calibration of SPTs** – SPTs are pinned to the respective KPIs. SPTs should be ambitious and provide lenders with confidence that a clear pipeline for the achievement of the KPIs has been put in place. For example, an SPT may include reducing greenhouse gas emissions within a project, where the KPI is a broader metric of reducing emissions over a longer period of time.
- **Loan characteristics** – For example, the margin under the relevant loan agreement will often be reduced where the borrower satisfies a predetermined SPT or KPI.
- **Reporting** – Borrowers should provide lenders participating in the loan with transparent and up-to-date information regarding their progress with meeting KPIs and SPTs.
- **Verification** – Borrowers are required to obtain independent and external verification of their performance level against each SPT for each KPI and share this information with the lender in a timely manner.

For the hotels sector, sustainability performance targets will likely relate to the "green design" of hotels, which could include reducing emissions derived from around-the-clock air-conditioning, lighting and hot water services. Lenders have expressed a desire to finance hotel assets that meet a 5-star National Australian Built Environment Rating System (NABERs) rating, meaning the importance of environmental considerations in hotel design cannot be understated.

ESG-conscious hotel developers are already experiencing significant benefits from focusing on green financing. Recently, major developers have obtained SLLs totalling more than US$1.1 billion. Off the back of a post-COVID-19 uptick in hotel development investments, the uptake of SLLs will undoubtedly continue to be popular among borrowers and financiers alike. Europe, through the European Union, has led the charge by implementing a broad legislative framework to support SSLs. This may be indicative of how Australia may also implement a similar framework to support green financing.

As governments across the globe continue chasing down emissions-reductions targets, green financing is set to power hotel developments – much the same as green hydrogen is poised to start fuelling the mining sector – something that surely must have developers excited.

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