Episode 2 - Sustainability Linked Finance: why should I care?

Nick Section 1

Hello and welcome to the second episode in Addleshaw Goddard's series of podcasts on sustainable finance. In this episode we will be discussing "why should we care about sustainable finance". You are again listening to myself, Nick Parkin and Emma Whitehall, part of the Addleshaw Goddard's finance team.

If you tuned in to our first episode you will already know that we have lined up a number of exciting speakers for this series who will be giving their thoughts and insight into sustainable finance. In this episode we will be hearing from Kate Lawlor, the CEO of Bruntwood SciTech, Jayne Cottam, CFO at Assura, Tim Claire, director at sustainable finance advisory firm Anthesis Group, Radi Ivanova from Barclays and Alison Barry and Vaughan Tyrell from HSBC.

Emma Section 1

In a recent sustainability survey run by AG as part of our Pain to Net Gain project, we asked the views of over 1,000 business and finance leaders across Europe and found that 81% of business leaders believe that the pandemic has been a driver for their organisation to act more sustainably.

We asked Kate Lawlor whether the pandemic had an impact on Bruntwood's sustainability strategy.

[KATE LAWLOR EPISODE 1 QUESTION 1][1]

[The pandemic didn't particularly have an impact as such. We had already gone down the route of sustainable finance in the past albeit not in quite such a structured way. One of the previous facilities that we had put into place with our banking club was under a sort of early form of a sustainability linked loan which was referred to as a green loan and that was back in 2019 and then prior to that, prior to sort of the formation of SciTech as a joint venture we had a loan into one of our subsidiaries Manchester Science Partnerships Limited that equally was also a green loan so we've been exploring options around sustainability linked finance, green loans for a number of years now and connected to our kind of wider commitment to sustainability initiatives that we've been following in the business again for some time we sort of see it as being very complimentary to what we're trying to achieve elsewhere and then also actually is helping justify the business case for a lot of our sustainability activity given the way in which the importance of sustainability in the wider funding market is beginning to grow].

Emma Section 2

We also talked to Jayne Cottam about what prompted Assura to explore sustainable finance and whether the pandemic had an impact on that.

[JAYNE COTTAM EPISODE 1 QUESTION 1][2]

[So from our perspective and this is a journey we started on a few years ago looking at you know if you think about what we do we provide medical centres so from a social side and a sustainable side it's really important what we do so we've already developed for example our first net zero carbon in use building and we are looking at sustainability when we are upgrading our existing buildings so I don't think the pandemic per se had a big impact on that. We actually launched our social impact strategy literally within a month of lockdown which people probably thought was to do with the pandemic but we'd been working on it for quite some time so I don't think the pandemic had an aeffect on that but it is

[1] Kate Lawlor – between 3.00 and 4.00 mins [1:07 – 2:10]
[2] Jayne Cottam – between 3.00 and 4.15 mins [2:17 – 3:15]

something that's hugely important to us as a business and you know we launched our social impact and our strategy and what it's about, its about maximising our impact in society whilst minimising our impact on the environment].

Nick Section 2

It seems both Assura and Bruntwood are slightly ahead of the curve in terms of adopting their sustainability strategies and obtaining sustainable finance. Given they have both spent the last few years focusing on sustainability, we wanted to see if they agreed with our research findings which showed that 75% of businesses believe that a sustainability focus gives them a competitive edge.

[JAYNE COTTAM EPISODE 1 QUESTION 2][3]

[Yes I do agree with that. I think if we don't do it then rather than it being a competitive advantage today it will be a competitive disadvantage in the future so a lot of companies aren't doing this but I think you need to look ahead with things like the government's targets on net zero. We work closely with the NHS, they have their own net zero target so if we don't do something as well we are going to get left behind and that will make us uncompetitive in our environment. If I look to sustainability linked finance, we haven't actually done any sustainable debt at the minute but we've done social and the two are very linked together and we definitely found a pricing advantage at that level because there's lots of investors who want to be associated with sustainable and ethical businesses and therefore that created a lot of demand and as there was a lot of demand then that drove the price to be a lot more competitive than if we'd just gone out for a standard bond so I definitely think that it does provide an advantage for businesses as well as being absolutely the right thing to do. I think you can't just go at it and just think oh its going to make us more competitive, you've got to believe in what you're doing otherwise you get accused of all kinds of things like green washing and all things like that and that's not where we are as a business.]

Nick Section 3

And this is what Kate had to say.

[KATE LAWLOR EPISODE 1 QUESTION 2][4]

[So do I agree with the fact that it gives us a competitive advantage first? Yes I do. Probably the real estate sector is relatively slow in the adoption of a lot of sustainability initiatives I think and I think the fact that we've been relatively forward thinking or we've tried our best to be as forward thinking as we can be in this area for the last couple of years has set us in really good stead. I think we've noticed over the last 2 years in particular but particularly the last 12 months there is such a focus on what we are doing from a sustainability point of view from our customer base and also from those sort of potential customers looking to come into our customer base and particularly for those more established corporate businesses they are almost using it as part of their initial due diligence into their property provider now to sort of ask questions around sort of how important is sustainability to us, what level of kind of investment have you made into your portfolio or planning to make that means that our business will be sat within an environment that has sustainability at the heart of it, and I think we've been pretty well positioned to be able to answer a lot of those challenges because of the fact that we have been thinking about it for some time so I think from a competitive advantage point of view, it does without doubt gives us a huge advantage and I think that will just continue to grow.]

[3] Jayne Cottam – between 4.30 and 6.00 mins [3:35 – 4:55]
[4] Kate Lawlor – between 4.00 and 5.45 mins [4:58 – 6:07]

Emma Section 3

So it's clear that having a sustainability focus will allow a business to be more competitive. But what other benefits, both tangible and intangible, do sustainability linked loans bring? We asked Radi Ivanova at Barclays to provide a bank's perspective on the benefits of sustainable loan products.

[RADI IVANOVA EPISODE 1 QUESTION 1][5]

[So naturally the sustainability linked product is a very flexible financing instrument where the borrower can access the funds and use them for whatever use they see fit, but also actually benefit from a pricing incentive if they achieve sustainability goals embedded in this financing instrument as well so a very obvious tangible benefit is the pricing incentive but I think from my experience with clients, the intangible benefits are much more impactful and what clients are actually after when they sign up for these types of structures. So what are these intangible benefits? One of the key ones, I think is around the organisational buy-in when we look at setting up a sustainability link loan. Often we see ESG teams and finance teams coming together having very open discussions around what are the common organisational sustainability objectives, how are those going to be achieved, talking about also innovation solutions and opportunities for costs improvement or revenue generation so it's really that sort of standard link structure which is a really effective tool to bring these parties together within a business and accelerate the buy-in internally from different stakeholders.

The second benefit which is probably the more obvious one is around making a clear commitment to the market, whether that is to customers, to investors, to banking partners, obviously every business is on some sort of transition agenda and trajectory so putting some very concrete goals that are monitored and are verifiable by external parties is a really strong statement around commitment to sustainability. As a sub-set to that, a lot of borrowers now are looking through to their supply chains as well as a big proportion of their environmental impact is actually contained and not just environmental but also social impact is contained within the supply chain so these types of borrowers more and more expect their suppliers to demonstrate sustainability commitment and they themselves could demonstrate that through a sustainability link loan as well.

The other big benefit of course is that banks and investors make their own sustainability statements around sustainable finance targets. I think that the desire to raise capital could actually improve access to liquidity for borrowers as well who are willing to put the right structure around that, and last but definitely not least, a lot of clients we speak to try to act as first movers from a sustainable finance perspective within the sector they operate in or the sub-sector they operate in but also to set the path for other borrowers or corporates within the same sub-sector and collaborate on what good looks like from a sustainable finance perspective so that is definitely another driver collaboration.]

Emma Section 4

We asked Vaughan and Alison at HSBC the same question and here is what they had to say.

[HSBC EPISODE 1 QUESTION 1]

[In many of the organisations that we have assisted there has been a tangible impact on the way in which different areas of the business come together where previously they had not. Finance sales, procurement strategy and sustainability professionals are brought together to engage in discussing and agreeing targets, breaking down internal silos and building collaborative working environments. Current and potential employees see the steps that have been taken by a business to meet their sustainable

[5] Radi Ivanova – between 1.18 and 4.30 mins [6:25 – 9:04]

performance targets and this builds the brand and reputation of the borrower as an employer of choice who is taking steps to be a better corporate citizen and making it a more attractive place to work.][6]

[ALISON - We care because at its heart this is the right thing to do. All work in this area represents our move towards a new way of ethical lending. The sustainability challenge is a global one and HSBC is genuinely committed to using its global scale to play a leading role in sustainable finance. Our commitment to net zero was included in our four strategic pillars announced in our annual results in February 2021. Speaking from experience these are not just grandiose statements in our annual resource, this commitment has trickled down to all levels of the institution. I am very much an example of someone whose role has changed quite significantly over the past 2 years. When documenting loan transactions I am now expected to be able to understand and explain to clients the journey to net zero but then to also be able to actually build this into our loan documents. Vaughan's role is even more of an example of that he has gone from client coverage to being a specialist in this area.][7]

[It is also an opportunity for us to become closer to our clients and have conversations with them beyond just pounds and pence. The increase in soft laws and regulation in this area mean there is an opportunity to provide a service to our clients to help them understand this. HSBC has made some of the most ambitious statements of any financial institutions re our goals for net zero. The main being that we will achieve net zero for our own operations by 2030 and we aim to be net zero for a finance portfolio by 2050.][8]

<u>Nick Section 4</u>

Despite 74% of the financial community believing that a business' sustainability strategy is a key indicator of its future profitability, only 51% of businesses have one that they share externally when requested and a meagre 7% proactively communicate their strategy externally. We wanted to find out what impact not having a sustainability strategy will have on a business' ability to seek finance in the future. Take a listen to what Radi had to say.

[RADI IVANOVA EPISODE 1 QUESTION 2][9]

[I think over time sustainability considerations become fully embedded in investment processes, we are already seeing a number of institutional investors and asset managers making very clear comprehensive commitments around integrating ESG considerations into the investment process, banks on the other side are making net zero statements which capture the finance permissions that they have basically the permissions of their clients so ultimately borrowers or clients that don’t have a carbonisation or transitional plan in place would probably suffer in terms of asset capital over time, but I think investors and banks are very much willing to work with borrowers and come up with a solution and I think everybody is aware this is the journey we are on and it's not a one size fits all approach.]

<u>Emma Section 5</u>

We've listened to both banks and borrowers discuss the importance of having a sustainability strategy and the various benefits that sustainability linked loans can bring. We spoke to Tim Claire, director at Anthesis Group, to find out what his top tips would be for businesses that are just starting to think about their sustainability strategy.

[TIM CLARE EPISODE 1 QUESTION 2][10]

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[6] Vaughan Tyrell – between 3.15 and 4.00 mins [9:10 – 9:47]
[7] Alison Barry – between 6.30 and 7.00 mins [9:48 – 11:27]
[8] Alison Barry – between 7.40 and 8.00 mins
[9] Radi Ivanova – between 5.10 and 6.15 mins [11:53 – 12:40]
[10] Tim Claire – between 16.15 and 19.15 mins [12:57 – 15:35]

[Don’t delay any further I think that would probably be my first reaction and take it seriously and crucially I think buy into the concept that this is going to make a difference to your business' performance and it is not just box ticking etc. etc. some of it will be and some of it will be regulatory driven, but the evidence is there that whether you are dealing or what we call value drags which is dealing with the risks that you know a future investor or a future purchaser might arrive and look at and go okay that’s a problem with the business, that’s going to cost me or you are looking for the efficiency improvements the general efficiency improvements of how can I reduce my energy consumptions [they cost that way] or looking for the real business innovation where you look at things differently and say in a sustainable future this element of what we do could be modified and that’s going to be attractive to customers. Those are the bits people need to look for and if you focus in on how this will make money for my business, then more people will engage in it and see the value in it and ultimately it will be more successful so I suppose ultimately if you go for it don’t do it piece meal but in some respects you know time is running out now in terms of and I don’t mean that in a sort of polar bear on an ice cap type way I mean in terms of the regulatory pushes and the market pushes are coming through now at such a rate that if you don’t act you will very very soon find yourself at a disadvantage whether it’s the next time you bid for a piece of work ,next time you try and raise finance or whatever, you are going to get yourself caught out and a great example is climate risk assessment now. It will be mandatory for large scale undertakings from I think next year onwards building up over time by 2025 most large businesses will have to have done an in-depth assessment of how climate change and that’s both transition and physical risks will impinge or alternatively boost the business and if you haven’t got that laid out, that will be transparent to investors and others looking at you so it's time to get moving.]

Emma Section 6

So I think it's fair to say that the pressure is on. Financiers are the new activists, putting sustainability at the heart of how they operate and placing great significance on companies’ sustainability strategy and performance. Business leaders need to embed sustainable thinking into their organisations and ensure that their strategies are both well-communicated and well-executed.

It makes good business sense to give proper consideration to your business' approach to sustainability. If you want to be a good corporate citizen, start thinking about your strategy now and don't get left behind.

If you're interested in finding out more about how a sustainability linked loan could benefit your business, please do not hesitate to contact us.

Thanks for listening, we've been Nick Parkin and Emma Whitehall. Tune in to our next episode when we'll be exploring sustainability targets.