KPMG

# Sustainable Financing

**Opportunities for alternative financing via the financial market for the property and infrastructure development sectors**

This thought leadership provides practical insights on sustainable financing in two (2) parts: sustainable financing development in the region, and the application of sustainable financing options in the property and infrastructure development industries.

## Sustainable financing gains prominence in Asia

COVID-19 has been a wake-up call prompting governments, businesses and investors to pay greater attention to environmental, social, and governance ("ESG") issues, and stimulating all stakeholders to chart a sustainable recovery. From various economic and social relief plans and recovery strategies, sustainable finance is recognised as part of the solution and this has set an opportunity for global players to refocus on the benefits of sustainability and responsible investment.

The 1H 2020 Sustainable Finance Review by Refinitiv Lipper[1] revealed that sustainable financing is gaining more traction across Asia. In 2020, data shows that European issuers account for the largest regional market for Sustainable Finance bonds with 53% market share, followed by 26% from the Americas and 16% from the Asia Pacific. Some of the key facts for full-year 2020 are as follows:

- ↑ 3% — **Sustainable Lending in the Asia Pacific**
- ↑ 34% — **Most active sustainable loan activity in Japan**
- ↑ 26% — **Green bond issuance totaled at US$222.6 billion**
- ↑ 106% — **Sustainability bonds (worth of US$127.6 billion)**
- ↑ 10X — **Social bonds (worth of US$ US$164.2 billion)**

1. Sustainable Finance Review Full Year 2020 (source: https://thesource.refinitiv.com/thesource/getfile/index/fb3a0105-6148-4df0-ba91-9a6d91428ae8)

The full sustainable finance landscape covers (1) deals related to ESG criteria such as social bonds, green bonds and sustainability linked bonds or loans; (2) use of proceeds/sustainable proceeds – bonds where a proportion of proceeds are being used for sustainable outcomes; and (3) capital raising or deal-making in sustainable industries.

The sustainable financing options discussed in this thought leadership are limited to **debt instruments** and were developed based on publicly available information.

## Types of sustainable finance – Debt Instruments

Globally, there are three common types of sustainable financing tools used as debt instruments, which are **green bonds, corporate green loans** and the latest syndicated banking product, known as **sustainability-linked loans ("SLL")**.

### Green Bonds

**Green bonds** refer to fixed income instrument used to raise funds for green projects via the capital market. The main difference between green bonds and regular bonds is that the proceeds from the issuance of the green bond are only applicable to "green" or "sustainable" projects. Some examples of green projects include buildings, assets or business activities with environmental benefits, such as renewable energy, low carbon transport or forestry projects.

As a sign of commitment, multiple regulatory bodies and organisations have published frameworks and guidelines on the issuance of green bonds. The globally most-referred-to standards are the Green Bond Principles ("GBP"), issued by the International Capital Market Association ("ICMA"). In ASEAN, the ASEAN Capital Market Forum ("ACMF") has published ASEAN Green Bond Standards, which was developed based on the GBP and customised to the needs of ASEAN member countries. In Malaysia, the Securities Commission Malaysia ("SC") has also published the Sustainable and Responsible Investment ("SRI") Sukuk Framework that can be used for issuance of green Sukuk (or Islamic bonds). It has become increasingly common for corporations in Malaysia to issue their bonds. For instance, large corporations in the real estate industry, technology, utilities, automotive and consumer products sectors are among those that have done so since 2018.

### Corporate Green Loans

**Green loans**[2] are defined as any type of loan instrument used exclusively to finance or re-finance, in whole or in part, new and/or existing eligible green projects. Green loans are perceived as an alternative for companies to finance their environmentally focused corporate initiatives. This is in line with initiatives from many banks to expand their product offerings through green lending.

The classification of green loans is relatively new with the recent issuance of Green Loan Principles ("GLP") by the Loan Market Association[3] in 2018. While still in its early years, green loan issuance has amounted to about US$ 60bn in 2018 globally. In the ASEAN region, ING Group issued the first GLP-compliant green loan to finance a portfolio of rooftop solar projects in Singapore in 2019.

### Sustainability-Linked Loans

The most recently introduced sustainable debt instrument that is gaining traction both regionally and globally is the **Sustainability-Linked Loan ("SLL")**. It is also known as either ESG-Linked Loan or Positive Incentive Loan. The difference between **SLL** and the **corporate green loan** is that the proceeds from SLL are not tied to any specific requirements or projects. The SLL can be allocated for general corporate purposes to improve the borrower's sustainability profile, such as aligning the loan terms to the borrower's performance against the relevant sustainability performance targets (i.e. reduction of greenhouse gas emissions).

The pricing of the loan is based on the corporate (borrower)'s ESG score or overall sustainability achievements such as emission reductions. It is commonly linked to a sustainability benchmark index such as the Dow Jones Sustainability Index. If the company achieves its sustainability target, it benefits from favourable interest rates on the loan. If it fails, it pays a higher rate. These loans are also governed by standards developed by the Loan Market Association. On the banking side, **the Principles for Responsible Banking**, which is a framework of the sustainable banking system, requires banks to explore alternative financing options for sustainable companies, including SLL.

2. Source: Green Loan Principles ("GLP") by the Loan Market Association
3. Source: https://blogs.worldbank.org/climatechange/green-loans-financing-transition-low-carbon-economy

## Drivers for the increasing adoption of sustainable finance

The pandemic has revealed not only our vulnerability as a society, but also our interdependence on each another. We are not able to isolate from the climate crisis, which presents a pressing challenge for humanity while also opening up enormous opportunities.

Soon, we will likely see sustainable financing transform into a more integrated approach. Investors will apply ESG integration and analysis across all categories of assets to enhance their risk and return performance. The Boards and CEOs of companies are expected to play their parts in addressing climate change, diversity, and other important societal issues.

Financing sustainable businesses has strong financial and broader societal benefits. The finance sector is in a unique position to incentivise the transition towards sustainable finance through lending, investment, insurance businesses that manage their nature risks and impacts. On the other hand, the private sectors with robust ESG management and monitoring system will be presented with an alternative financing mechanism to finance its ESG-driven initiatives.

Apart from being on trend and supporting the flow of funds to sustainable development projects, there are other benefits of sustainable financing which your business can consider.

| Sustainable financing options | Green Bonds | Green Loans | SLL[4] |
|---|---|---|---|
| Source of Capital | Higher capital input to develop an internal management process for green bond issuance and to maintain the infrastructure based on dedicated green criteria. | Lower capital input with a more flexible application procedure | Lower capital input, as the loan is provided based on pre-determined sustainability performance |
| Company financial and operating cost | Potential to increase in the stock price[5].<br>Improvement in operating performance as measured by the return on assets[6]. | Lower operating costs to improve the borrower's sustainability profile | Lower operating costs to manage green infrastructure and improve borrower's sustainability profile |
| Uplift Company's Brand & Reputation | Yes | Yes | Yes |

4. Source: https://www.wfw.com/articles/the-rise-of-green-and-sustainability-linked-loan-financing/
5. Source: https://hbr.org/2018/11/green-bonds-benefit-companies-investors-and-the-planet
6. Source: https://hbr.org/2018/11/green-bonds-benefit-companies-investors-and-the-planet

## Sustainable financing in Malaysia – Exploring the feasibility

Issuance of **sustainable (including green) bonds or Sukuk** in Malaysia was initiated in 2014. As of December 2020, there have been fifteen (15) issuances of sustainable bonds in Malaysia with issuance facility of up to RM6.3 billion. The bulk of the proceeds from the issuances are for renewable energy projects, covering both solar and hydro-powered generation. Aside from that, proceeds from two of the issuances are for the development of green buildings, which are the Warisan Merdeka Tower (KL118) and gateway@ KLIA2 mall.

CIMB Investment Bank Berhad and MIDF Amanah Investment Bank Berhad have become the principal advisers in three of the sustainable bonds/ Sukuk issued. The cost of issuance of the bond/ Sukuk varies by the advisers selected. If the issuer decided to list the sustainable bond/ Sukuk on Bursa Malaysia, the cost of the initial listing is RM15,000[7].

In May 2020, OCBC Al-Amin Bank Bhd ("OCBC") awarded Axiata Group Berhad ("Axiata") with the first **SLL**, worth US$800 million (about RM3.5 bn). It is the largest syndicated financing transaction undertaken in Malaysia amid the current pandemic. Structured in compliance with Asia Pacific Loan Market Association ("APLMA") Sustainability Linked Loan Principles 2019, the loan is given to Axiata in recognition of the company's sustainability commitment to reduce carbon footprint emissions. Axiata's sustainability framework[8] is in line with OCBC Group's sustainability financing commitment, as one of the main advocates of green and sustainable financing in the region.

There are a few initiatives from the Malaysian government in supporting **sustainable bond/ Sukuk**:

1. **Tax Deduction:** For issuance of SRI Sukuk, the tax deduction is given to the issuer until the year of assessment (YA) 2023 on issuance costs of SRI Sukuk approved, authorised by or lodged by the SC. To be eligible for tax deductions under SRI Sukuk incentives, issuers utilising the SRI Sukuk framework towards green projects must ensure that proceeds raised are used to fund eligible SRI projects in the natural resources, renewable energy and/or energy efficiency sectors.

2. **Grant:** Capital Market Development Funds ("CMDF") are providing Green SRI Sukuk & Bond Grant Scheme worth a total of RM6 million. The Grant Scheme is introduced to finance the external review expenses from the issuance of Green SRI Sukuk and Bonds, with a limit of RM300,000 per issuance. Compliance requirements to either of the following national and regional standards (i.e. SC's SRI Sukuk Framework or the ASEAN Green, Social or Sustainability Bond Standards).

3. **Tax Exemption on CMDF Grant:** The Government of Malaysia is providing income tax exemption from the grant received from CMDF for external review expenses in the issuance of Green SRI Sukuk and Bonds. This exemption is provided until 31 December 2025.

4. **Green Technology Financing Scheme ("GTFS")**: Green Technology Financing Scheme 3.0 (GTFS 3.0) is introduced by the Ministry of Energy, Green Technology & Water in 2020 to accelerate the growth of the green technology industry in Malaysia. RM2 billion was allocated to producers and users of green technology with an application window of two (2) years (from 2020 up to 2022). An important feature is that GTFS will be guaranteed by Danajamin to encourage the issuance of SRI Sukuk and spur an aggressive kick start to energy efficiency businesses that are deemed as new economic growth areas in the renewable energy sector.

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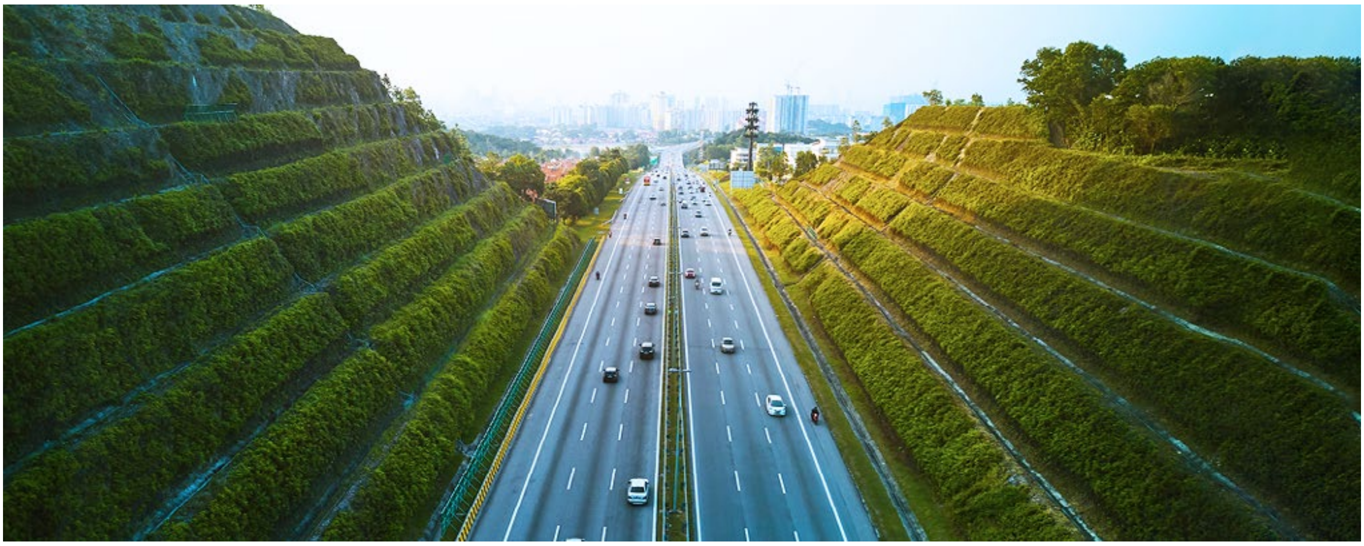
7. Source: Bursa Malaysia
8. For more information on Axiata's sustainability framework, please refer to its Sustainability Report 2019: https://www.axiata.com/investors/2019/sustainability-report.html

## Sustainable financing for property and infrastructure development companies – Where to start?



Since 2013, property and infrastructure development companies have shown an interest in tapping into sustainable finance as an option to finance its green or sustainable projects. The Covid-19 pandemic has augmented the transition towards sustainability. With more countries onshoring their supply chains and against the backdrop of low interest rates, property and infrastructure development as an asset class have become increasingly attractive for investors.

**According to an estimate by Asian Development Bank ("ADB"), developing Asia will need to invest US$1.7 trillion per year in infrastructure until 2030 to maintain its growth momentum and tackle poverty and climate change**. It is, however, noted that governments have diverted some funding previously allocated to infrastructure for other uses in response to the pandemic. In addressing the infrastructure financing gap in Asia, ADB, Clifford Capital and other development institutions have stepped up the collaboration by injecting US$95 million to spur the growth of sustainable infrastructure financing and real estate development in Asia[9].

Globally, there are various industry-specific frameworks and guidelines for the companies to embark on sustainable financing. Amongst others include the Green Bond Guidelines for the Real Estate Sector by the Global Real Estate Sustainability Benchmark ("GRESB") and the Sustainable Real Estate Investment Implementing the Paris Climate Agreement: An Action Framework by the United Nations Environment Programme Finance Initiative ("UNEP FI").

Here are some examples of key steps for property and infrastructure development companies to consider:

1. Develop a company-wide ESG/ climate strategy by taking into account the material ESG risks and opportunities that are impacting the companies
2. Set ESG/ climate goals and targets across the company and your supply chains, such as carbon reduction targets, energy-saving targets, water reduction targets and waste management targets.
3. Integrate the ESG/ climate strategy by implementing various sustainability initiatives in day-to-day business operations such as ideation phase (e.g. pre-construction, design and investment), construction phase, and post-construction phase.
4. Develop a robust sustainability performance monitoring tool to track the outcome of the sustainable programmes (i.e. environmental and social impacts).
5. Identify green project eligibility criteria and appropriate metrics for performance monitoring throughout the value chain – from planning and design, land use and biodiversity, materials sourcing and transportation, civic infrastructure, energy and water pollution, tenant and community health and well-being[10].
6. Implement and managing investment proceeds based on the set green eligible criteria.
7. Communicate Green Property Bond outcomes through the issuance of an annual report to maintain market credibility.

9. https://www.businesstimes.com.sg/banking-finance/adb-invests-us95m-to-support-sustainable-infrastructure-development-via-clifford
10. Green Bond Guidelines for the Real Estate Sector by the GRES

# Learning from other leading industry players

## Case Study 1

### Stockland Corporation Limited - Issuance of Green Bonds

In 2014, Stockland Corporation Limited ("Stockland"), Australia's largest diversified property group, has issued a EUR300m (US$380m), 7-yr green bond. The bond is currently rated A-, with a 1.5% coupon. Underwriters to the bond were HSBC and UBS Group AG ("UBS"), and the bond is listed on the Singapore Stock Exchange.

Stockland's green bond is Australia's first green bond and its green bond framework was reviewed by KPMG. Additionally, the annual report of the green bond issuance was also reviewed by KPMG (as a third-party reviewer). The review is to confirm whether the management of proceeds of the green bond is in compliance with Green Bond Principles and that Stockland's Green Bond Management Statement is in accordance with the International Standard on Assurance Engagements other than Audits and Reviews of Historical Financial Information.

Proceeds from the issuance of green bonds will go to investment in the development, redevelopment or tenant improvements that have, or expected to receive, Green Star ratings of 4, 5 or 6 or equivalent. The Green Star-Communities rating tool administered by the Green Building Council of Australia ("GBCA") is a voluntary certification that recognises the achievement of best practice sustainability outcomes. Additionally, proceeds can be allocated to capital projects that have a third-party verifier that any targets for reduction in energy, water and/or waste will be achieved. Stockland will also apply their sustainability policies to select projects within these categories.

## Case Study 2

### CapitaLand Limited – Corporate Green Loans and Sustainability-Linked Loans

CapitaLand Limited ("CapitaLand"), Asia's largest diversified real estate groups and its real estate investment trusts, raised around US$2.42 billion in less than two years through sustainable financing instruments. CapitaLand has received two types of sustainable financing instruments, the corporate green loan and Sustainability-Linked Loan, received from multiple global financial institutions since 2019.

In 2020, US$400 million worth of corporate green loans were approved for CapitaLand in the form of bilateral green loans to support the greening of the CapitaLand's global portfolio by 2030. DBS Bank Ltd ("DBS") provided the first US$150 million four-year green loans, while HSBC provided the other US$250 million three-year multi-currency green loans. Proceeds from these green loans will be used for financing or refinancing of the development, investment and acquisition of certified CapitaLand green buildings. Certified green buildings are required to achieve or are expected to achieve a minimal, Green Mark GoldPLUS certification by the Building & Construction Authority of Singapore ("BCA"), or a Leadership in Energy and Environmental Design ("LEED") Gold rating by the United States Green Building Council.

CapitaLand also received a US$500 million sustainability-linked loan from United Overseas Bank ("UOB") in 2020. The loan is explicitly linked to CapitaLand's achievements as measured against the GRESB. In the GRESB 2019, CapitaLand came in first place across four categories and was also the leader in the Global 'Diversified - Listed' category with the highest tier rating of 5 stars.

Launched in 2020, the five-year multicurrency sustainability-linked loan is linked to ESG performance of CapitaLand, which is evaluated based on RobecoSAM Corporate Sustainability Assessment ("CSA") and the company's listing in the Dow Jones Sustainability World Index. If the performance targets are met, the interest rate on the loan will be reduced, reducing the company's cost of debt.

## Common Challenges

Despite many initiatives that have been introduced to boost the market, there are a few common challenges faced by issuers and other participants in the sustainable finance industry.

In this section, we highlight some of the common pitfalls market players should observe:

01

### Definition of "sustainable" or "green" criteria/ products

To avoid the 'greenwashing' sentiment, corporations are encouraged to firmly assure whether its project for utilisation of proceeds from the issuance of green bonds/ Sukuk or tied to the green loan is truly green, to ensure investors' confidence and attract funding. In Malaysia, Bank Negara Malaysia aims to provide a taxonomy that can be used to define projects as "sustainable" or "green". While waiting for the release of the taxonomy, KPMG recommends for corporations to have due diligence on the greenness of projects selected or adoption of any global, regional or national standards.

02

### Availability of reliable data tracking platform

Lack of robust data tracking processes could be a major hindrance for companies to track and report on the intended environmental benefits associated with its development projects (for example, data on energy-efficient, water savings, carbon reduction, etc.). These challenges are particularly integral for SLL, as lenders would need to verify a corporation's commitment to its sustainability goals, which can only be proven with a good data tracking platform.

03

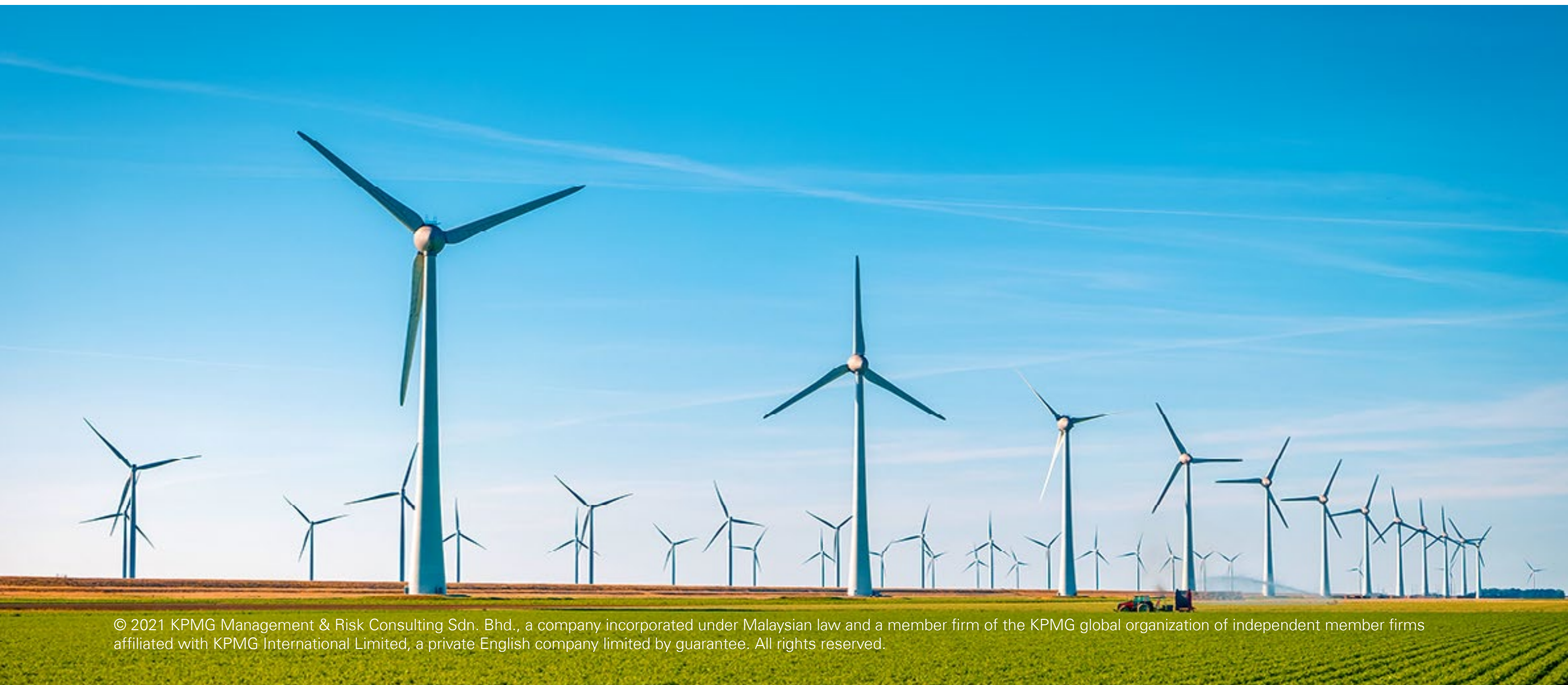
### Sustainable Financing Standard

With so many different sustainable financing guidelines and standards available, ranging from the GPB to sector-specific standards, navigating this landscape can be challenging and requires subject matter experts from the financial institutions, acting as principal advisors to the corporation.

04

### Transparency on sustainable financing management

Global and national investors are becoming more demanding and would request independent assurance/ third party verification on sustainable instruments. For example, in bonds/ Sukuk issuance, the demand is to have the proceeds be monitored and managed appropriately, with verification in the form of annual/ quarterly reports from the third-party verifiers.



# How KPMG can help

KPMG stands ready to help our clients with sustainable financing and green bond issuance and guide you on your ESG sustainable financing journey. Supported by the KPMG global network, our Governance & Sustainability professionals will draw on broad industry knowledge and experience to look at sustainable finance for both borrowers (i.e. Corporates) and lenders. We can help financial institutions build their sustainable finance expertise as a core part of the investment strategy. For Corporates, we can support businesses integrating ESG factors into debt facilities to access broader pools of capital and debt pricing benefits for delivering ESG impact.

Our professionals can offer bespoke sustainable financing services to match your differing needs no matter what stage you are at in your sustainable financing journey. This chart provides an overview of the areas we can support you with.

Choose underwriter

Registration/ application

Information disclosure

Get credit rating

Issue bond

Allocation of proceeds

### Review funding options

Issuers should review the business case for green bond issuance, consider how it matches with their financing objectives and sustainability strategy, and weigh the benefits against the specific challenges, which may include:

- Issuance and ongoing tracking, monitoring and reporting costs
- Keeping a 'closeness' to conventional bonds,including returns
- Reputational risks associated with 'greenwashing' accusations
- Heightened scrutiny of environmental credentials
- Penalties for green default (whereby a bond ispaid in full but the issuer breaks agreed green clauses)

### Design green bond criteria and project selection process

There is no universally agreed standard for a green bond and the kind of activities that can be funded. Issuers can look to several evolving guidelines and sources such as the **Green Bond Principles**, the **Climate Bonds Standard**, national guidelines, green bond indices and sector-specific standards for guidance in defining their green bond and the process used to determine the eligibility of projects.

### Processes and controls for use/management of proceeds

Setting up robust management and controls for tracking and allocation of proceeds is recommended to ensure the proceeds are used in line with the terms of the bond. The following areas should be considered while designing the tracking mechanisms and processes:

- **Tracking of proceeds**
- **Management of proceeds**
- **Management of unallocated proceeds**
- **Assurance**

### Ongoing reporting

Reporting on the allocation of proceeds and the environmental and/or social outcomes of the investments regularly during the life of the bond or projects invested in is increasingly expected by investors. In preparing for the disclosure of the green impact of the underlying assets or investments, issuers are recommended to consider:

- Designing monitoring and evaluation processes in advance
- Implementing key performance indicators (KPIs) and data collection systems to monitor environmental outcomes of projects over time
- Seeking third-party assurance to reduce data quality risks and raise stakeholder confidence in disclosures

## KPMG's support throughout the life of a green bond

**Review funding options**

- Review financing objectives and options
- Determine a funding route
- Act as a sounding board for management

**Choose underwriter**

*Issuance Support*

- Provide advice on selecting bond underwriter

**Design green bond criteria and project selection process**

- Develop 'green' criteriaand management of proceeds criteria
- Review processes and controls
- Benchmark green bond framework

**Processes and controls for use/management of proceeds**

- Assurance over bond criteria, processes and controls

**Information disclosure/Get credit rating**

*Issuance Support*

- Provide advice on the credit rating process,presentation to investors, commercial terms and reaching financial close

**Ongoing reporting**

*Monitoring and Reporting*

- Develop monitoring and reporting processes/KPIs
- Supportinternal/external reporting

*Third-party Independence Assurance*

- On processes and controls for selecting projects, managing proceeds and on progress reports

*Financial Advisory*

- Ongoing financial advisory assistance
- Support investor management

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