Loan Radar and LFRD ESG Wrap 2023

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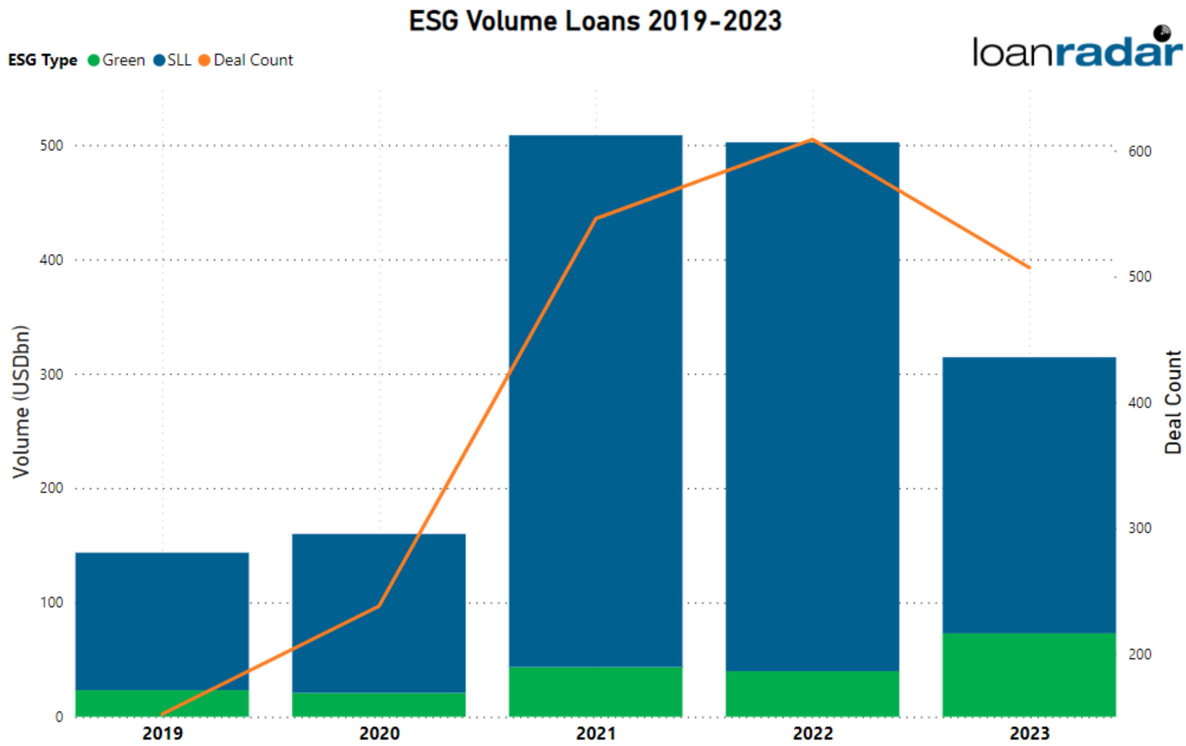
2023 was a challenging year for the loan market, volumes fell year-on-year in both Corporate and Financials and Asset Finance, while Leveraged Loans experienced a modest recovery after a poor 2022 for volumes. Across the board issuance has been constricted by macroeconomic headwinds, as interest rates continued to climb in response to sky-high inflation, international conflicts dominated headlines, and creeping default rates and a lack of investor demand have caused lenders to pause for thought.

Volumes of sustainability-linked loans (SLL) and green loans have decreased in line with wider volumes as the below graph highlights.



Volumes dipped to USD330.88bn from 455 deals in 2023, down from USD502.43bn from 567 deals in 2022. 2023 saw a re-evaluation of the SLL product, as borrowers weighed up the potential rewards as well as the added scrutiny that SLLs bring.

Gemma Lawrence-Pardew, Head of Sustainability, Director – Legal at the Loan Market Association argues that “general market conditions” as well as a “large flux in the regulatory market, particularly in regards to ESG disclosure requirements” were contributing factors to the drop in ESG lending in 2023.

She further pointed out that following the publication of a letter publishing the FCA’s concerns around the sustainability-linked loan market in June “institutions took a pause and took stock to make sure that the loans they were labelling as sustainability-linked were truly meeting the criteria set out in the principles”.

The LMA published its updated SLL and Green Loan Principles in February 2023, as well as its model provisions for SLLs in May 2023, reinforcing its guidance and providing a recommended framework to articulate the fundamental characteristics of the products. Lawrence-Pardew stated that the goals of the updated principles were to provide greater “clarity, transparency and granularity” around Sustainability-linked loans and green loans.

According to Vai Patel, Head of ESG at Alcentra, there has been “more scrutiny from stakeholders regarding greenwashing in 2023, which is welcome”, acknowledging that while volumes are down, he argues that it has “largely mirrored the wider market rather than any specific concerns with sustainability-linked lending as a format”.

Reflecting further on 2023, Patel stated that “while rate rises caused overall margin increases, there wasn’t a corresponding jump in ESG margin adjustments” showing that sustainability-linked lending was “never meant to be purely an economic tool” but rather that the mechanism was designed to “ensure there is an alignment of ESG priorities between the borrower and lender(s) across the whole life of the loan”.

Green Loan Deal Highlights

Green loan volumes have risen 74.61% year-on-year, with USD79.4bn raised from 142 green loan. 91 of these loans were used for Asset Finance, while 48 were Corporate and Financials, and three were Leveraged Loans.

The largest green loan of the year was signed in December, as US renewable energy and transmission infrastructure company Pattern Energy secured a multi-tranche USD11.05bn non-recourse Green Loan to fund the ongoing construction of the SunZia Transmission and Wind project in New Mexico and Arizona.

SunZia Transmission and Wind represents the largest clean energy project in US history, harnessing and delivering renewable energy to meet growing demand in the West of the country.

The facility comprises a USD2.25bn tax equity term loan and USD8.8bn of construction and term facilities and is aligned with Green Loan Principles.

The largest green loans are often those financing major renewables projects, February saw a USD6.18bn ECA-backed green term loan facility signed to fund the construction of a green hydrogen mega-plant in Saudi Arabia. The financing for the project has been certified by S&P as adhering to green loan principles.

The mega-plant, which is aiming to be the largest in the world, is being constructed by NEOM Green Hydrogen Company, an equal joint-venture between Air Products, NEOM and ACWA Power. The plant is currently under construction in the city of Oxagon, in Saudi Arabia's NEOM region.

The plant is expected to produce up to 600 tonnes per year of carbon-free hydrogen by 2025, in the form of green-ammonia.

In September a USD5.2bn ECA-backed green credit facility was signed to fund the Baltic Power project, a 22km wind farm off the cost of Poland.

The project is a joint-venture between PKN Orlen (51%) and Northland Power (49%) and is expected to power over 1.5 million Polish households once operational. The loan represents approximately 80% of the total project cost.

Sustainability-linked Loan Deal Highlights

Sustainability-linked loan volumes have plunged 43.1% year-on-year, as volumes equaled USD260.96bn from 323 deals. Of these deals, 264 were Corporate and Financial, 39 were Asset Finance, and 20 were Leveraged Loans.

The majority of major sustainability-linked loans in 2023 were RCFs secured by blue-chip companies. The largest such deal saw New York-listed automotive giant Ford extend the maturities of USD17.2bn of its ESG-linked revolving credit facilities in April. The facilities comprised a 364-day USD1.8bn tranche, a three-year USD1.9bn portion, a three-year USD3.4bn multi-currency tranche, and a five-year USD10.1bn multi-currency portion.

The deal is subject to pricing adjustments based on the company's performance against KPIs for carbon emissions reduction during the manufacturing process, the implementation of renewable energy supply in manufacturing, and Ford Europe reducing passenger CO2 tail-pipe emissions.

The largest sustainability-linked deal secured by an EMEA-based borrower saw Madrid-listed utility giant Iberdrola sign a 5+1+1-year EUR5.3bn RCF for general corporate purposes in December.

The facility's margin is linked to the borrower's performance against KPIs related to the reduction of emissions and an increase in the percentage of women in relevant positions.

A frequent borrower in the loan market, Iberdrola also secured an ECA-backed EUR500m green loan in July to finance the construction and development of an offshore windfarm off the coast of the UK.

Dutch commodities trader Trafigura signed a dual-tranche USD5.42bn sustainability-linked revolving credit facility for GCP and to refinance existing debt in March 2023. The facility comprises a 365-day USD1.9bn RCF and a three-year USD3.52bn RCF.

Both tranches have pricing linked to KPIs including cutting operational greenhouse gas emissions, responsible sourcing of metals, and growing the renewable power portfolio.

Trafigura tapped the market six times in 2023, and also signed a sustainability-linked USD2.7bn credit facility in October for refinancing and GCP.

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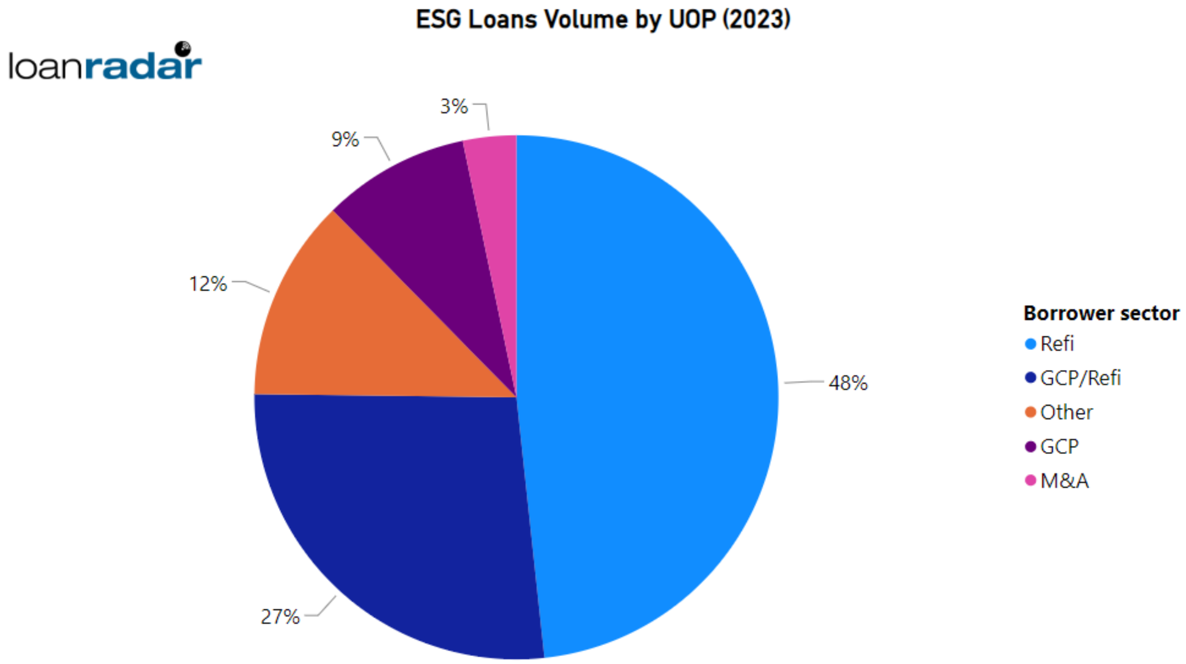
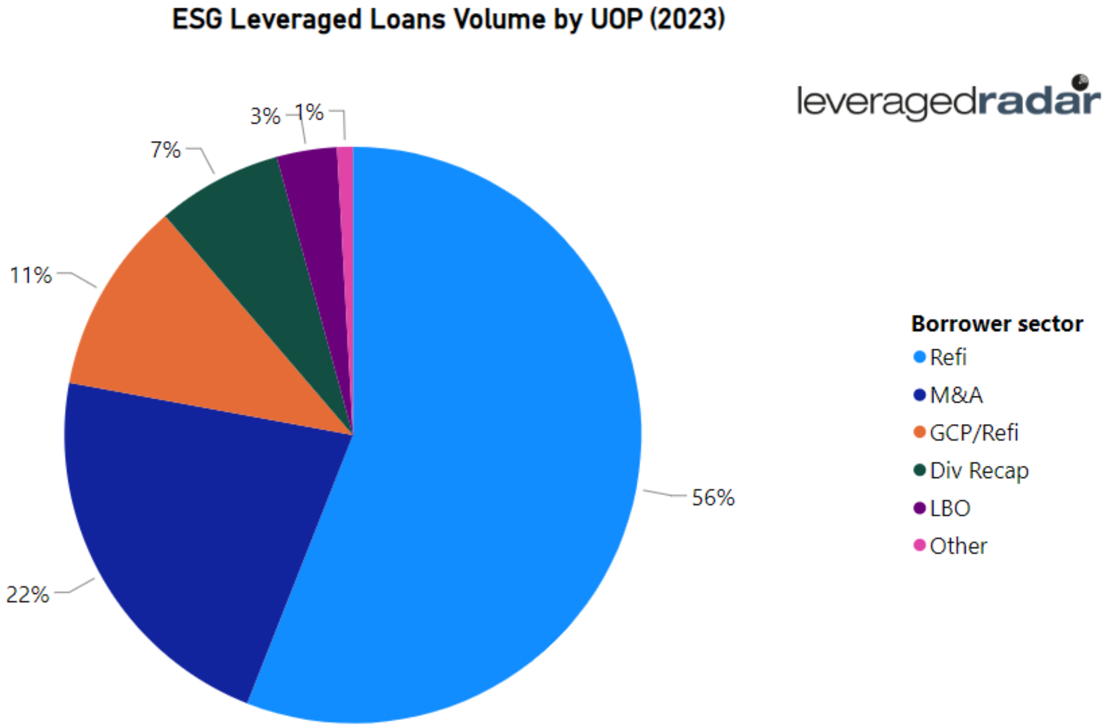
Use of Proceeds



48% of green and sustainability-linked Corporate and Financial and Asset Finance volumes were used solely to refinance existing debt in 2023, while a further 27% were used for GCP and to refinance debt.

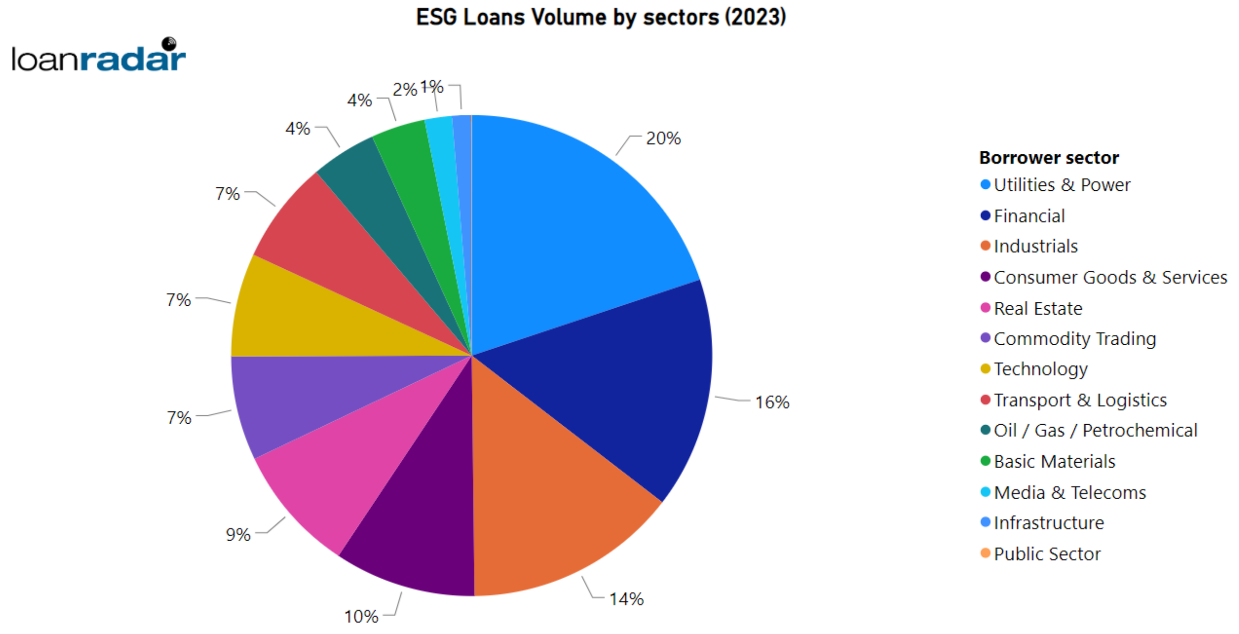
12% of volume was used for other reasons including project financing, while only 3% of deals were used for M&A.



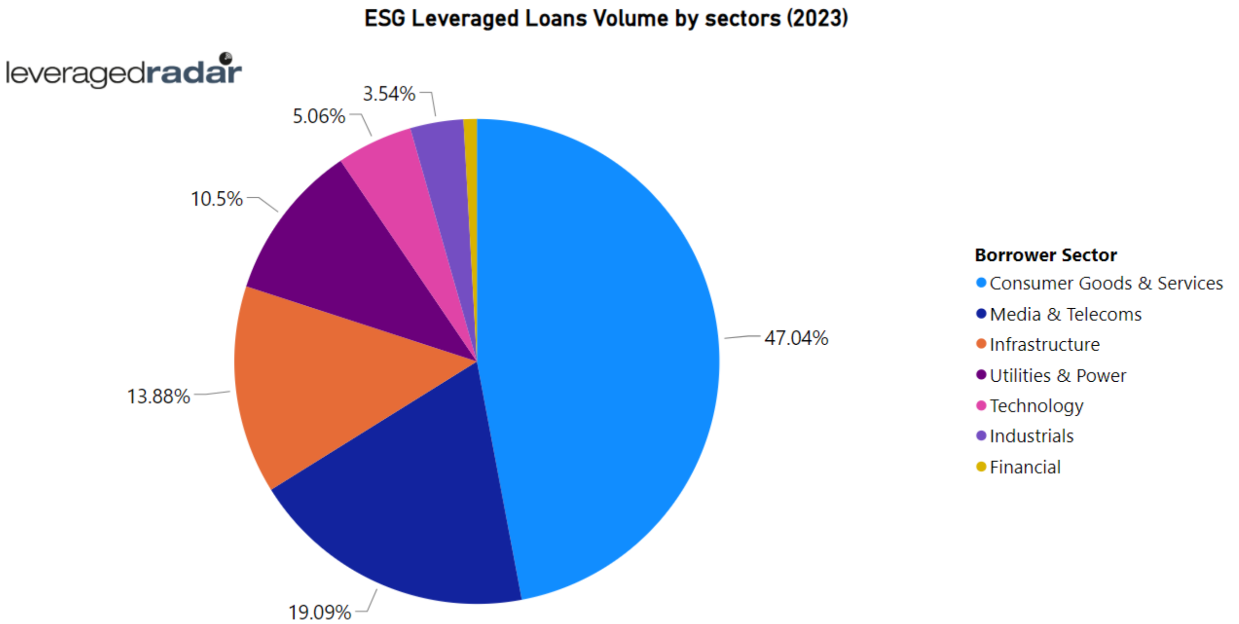
In the leveraged loan market, 56% of ESG loan volume refinanced existing debt in 2023, while a further 11% was used for GCP and to refinance debt.

22% of ESG loan volume was used to finance M&A, including an upsized EUR790m add-on TLB backing two bolt-on acquisition by Carlyle and CVC-backed UK-based women's pharmaceutical company Theramex.

Sector Breakdown

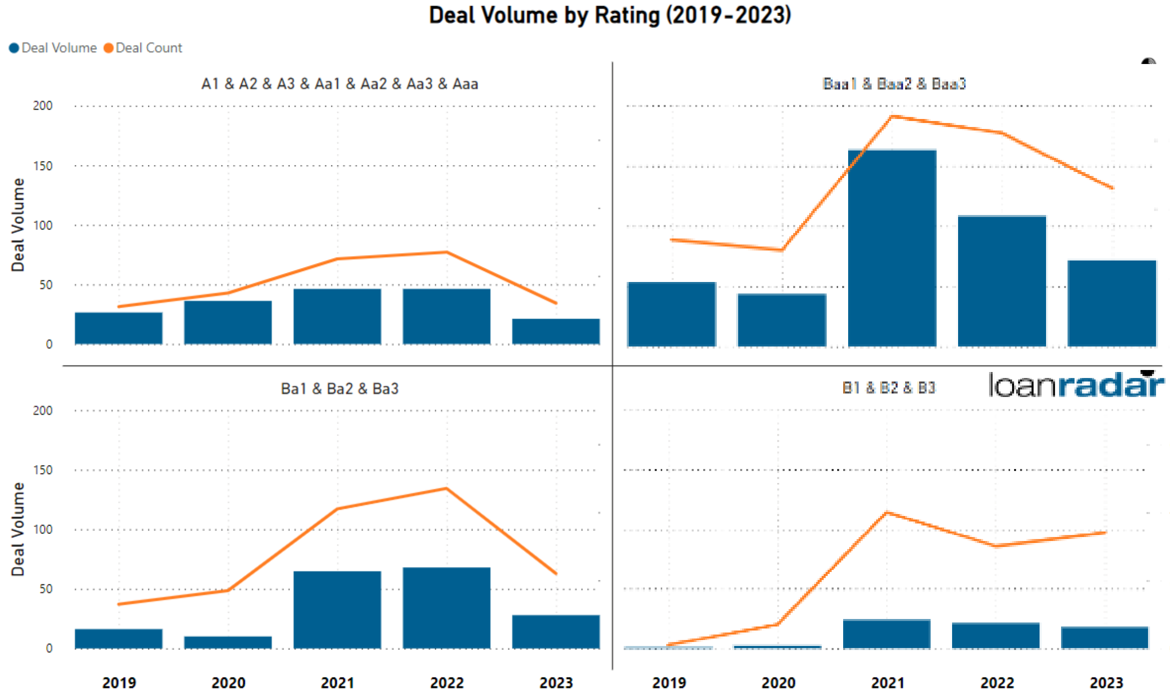


In Corporates and Financials and Asset Finance, Utilities and Power companies secured 20% of the volume of ESG loans, with borrowers from financial institutions receiving 16% of ESG volumes, and borrowers from the industrials sector collecting 14% of ESG volumes.



In the leveraged loan market, companies providing consumer goods and services borrowed 47% of ESG loans volume in 2023. Media & Telecoms had the next highest proportion with 19%, followed by the infrastructure sector which borrowed around 14%.

ESG Deal Volume by Rating



As the above graph shows, volumes are down across the ratings spectrum. 'Single B' rated issuers have concluded more ESG deals than last year, while the number of deals in all other ratings groups has fallen.

Looking Ahead

Evolving regulatory requirements and guidance are driving changing ESG expectations in the loan market and borrowers are now required to provide more ESG data than ever before to access the market. Vai Patel, Head of ESG at Alcentra commented that "the EU's CSRD is expected to affect up to 50,000 entities that are not currently required to report on ESG activities" and that "while regulation is a positive step, it will take time for borrowers to adjust to the new requirements".

SLLs and green loans undoubtedly remain a key tool within sustainable finance and are here to stay for the future. Increasingly in 2023, borrowers sought sleeping SLLs to give them more time to process the more stringent LMA guidance and agree on achievable KPIs with lenders. With a number of these sleeping SLLs becoming active in 2024, and macroeconomic conditions seemingly settling, volumes seem likely to rise in the new year according the market sources.

All data, unless otherwise stated, sourced from the Bond Radar Ltd Data Wizard and API leveragedradar

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