ESG is business-critical for housing - how do you make sure your business strategy and funding are aligned?

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ESG funding - the terminology is confusing and interchangeable, there are multiple sets of standards and reporting frameworks and everyone wants to talk about it, but what exactly is it? In its broadest sense, ESG stands for Environmental, Social and Governance and usually refers to a set of criteria or standards by which a company is judged either in relation to the use of proceeds of that bond or loan or in relation to a financial incentive.

It is hard to know where to start, so we took a look at some examples of ESG funding both inside and outside the social housing sector to identify some of the trends.

Environmental

The climate crisis has been steadily rising up the agenda, and green bonds linked to environmental change were the first type of mainstream ESG funding. The International Capital Markets Association published its Principles for issuing Green Bonds in 2014, and issuance in 2019 marked a new global record of green bonds and loans of more than US$257billion issuance worldwide. Many have been linked to reductions in carbon emissions, such as the $10bn loan issued by Royal Dutch Shell plc in 2019.

It is not just large energy companies that have highlighted their green credentials. Luxury goods companies like Prada have funding linked to the use of regenerated nylon for the production of goods as well as the regeneration and reconversion of production waste.

You would expect that with a large property portfolio in need of retrofitting to reach zero carbon, as well as development ambitions to deliver sustainable and affordable housing, green bonds would present housing associations with a significant opportunity for raising funds. However, to date there have not been very many green bonds issued by housing associations, possibly because it would require a large sum of capital to essentially be ring-fenced for a specific green project or projects. However both Clarion and Aster have now issued Sustainability Bonds which have to be used for suitable sustainable projects; this could include green projects such as investment in retro-fitting for existing stock.

There has also been an increasing number of loans from registered providers where pricing has been linked to environmental targets, such as Metropolitan Thames Valley, Bromford Homes and Cartrefi Conwy, all of which have loans where pricing is linked to metrics relating to improving the energy efficiency of existing homes and in some cases their offices. The proceeds from these loans do not have to be used in order to achieve those targets, although it is likely they will be at least partly funded by the related loan. Instead the applicable interest rate reduces if energy efficiency targets are met.

With the current focus on zero-carbon we expect to see many more bonds and loans linked to similar environmental targets.

A good place to start

thegoodeconomy.co.uk/sectors/affordable-housing

Social

By its very nature, the social housing sector is well-placed to deliver on social credentials. In fact, an increase in the number of affordable housing units developed by a borrower is specifically identified as a social activity in the International Capital Markets Social Bond Principles, and social bonds have been issued by MOR Homes and Sage Housing.

It should be no surprise therefore that the majority of ESG loans borrowed in the sector have had KPIs linked to their social purpose in one way or another. Clarion, for example, has loans from Natwest, SMBC and BNP Paribas, all of which contain metrics relating to employment such as the number of apprentices hired on its construction site and the number of people supported into work. Catalyst has a loan from SMBC linked to targets for assisting customers with maximising their income.

In the wider corporate world, while it might seem harder to deliver against the social criteria, Prada has KPIs linked to the amount of training hours for employees and which could easily be replicated by RPs.

Governance

Governance-linked targets have lagged behind the 'E' and the 'S' in relation to ESG funding in the sector, which could simply be down to the fact that governance does not translate as well to a specific, measurable 'target' or comparator (after all, what is right for one organisation may not be right for another and this will change over time). It is also fair to say that funders expect housing organisations to already demonstrate excellence in governance, particularly given regulatory demands - this is one of the reasons why funders find the sector so attractive.

So, where might governance targets emerge? The key themes in the National Housing Federation Code of Governance 2020 are one indicator. For example, making meaningful progress in equality, diversity and inclusion, particularly focused around executive and board leadership of the sector. Bromford entered into a loan with NatWest in February 2020, which was linked to KPIs relating to the gender pay gap.

We could also begin to see more around resident engagement in governance, with the roll-out of reforms proposed in the Charter for Social Housing Residents: the Social Housing White Paper.

Where should I start?

Perhaps it should not be a surprise that the majority of loans have focused on the E so far - but arguably the social housing sector is well placed to take advantage of all aspects of the E,S and G of sustainable finance, so how do you prepare your organisation for this?

A good place to start is by considering the criteria set out in the Sustainability Reporting Standard for Social Housing which has been developed by The Good Economy in collaboration with RPs and investors. [https://thegoodeconomy.co.uk/]. How can you apply these criteria to your business streams? Perhaps you have a programme to reduce fuel poverty or a target to improve complaints handling? What percentage of your existing homes have EPC ratings above C? Are you actively promoting biodiversity or responsible sourcing of building materials? How do you support the physical and mental health of your staff?

By using the framework you can identify relevant criteria and targets that are challenging and meaningful and more than just "business as usual". Setting your strategy in line with the Standards will make it easier to provide data in a format that is consistent with the requirements of investors. It is not just about attracting cheaper funding, but developing an ESG strategy can drive forward improvements in all areas of the business, support the values of an organisation, reflecting its charitable purpose and the long-term stewardship role of boards.