Financing Green Hospitality: Empowering Hotels with Green Loans and Sustainability-Linked Loans

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It is estimated that there are over 17.5m hotel rooms globally, with more in the development pipeline. The hotel sector, like the broader built sector, therefore, has a significant role to play in shaping the future of buildings and their carbon footprint.

Hotel owners and developers needing to raise debt finance are well placed to take advantage of the green financing available in the market. Green Loans and Sustainability-Linked Loans are two distinct financing options that focus on sustainability. Green Loans are specialised financing options designed to support environmentally sustainable initiatives. Previously we have written on sustainability-linked loans. Sustainability-Linked Loans can empower hotel businesses to adopt environmentally responsible practices by tying loan terms and benefits to the achievement of specific sustainability goals. These loans can be tailored to provide financial assistance for hotels to implement energy-efficient technologies, reduce carbon footprint, and adopt eco-friendly practices.

- Purpose and Scope: Green Loans are specifically designed to provide financing for eligible green projects. These loans can target specific projects aimed at improving energy efficiency, water conservation, waste management, and other environmentally friendly practices within hotel developments. Examples of this for the hotel industry may be a hotel development targeting accreditation from a recognised standard such as BREEAM or an existing hotel upgrading energy systems by, for instance, replacing inefficient gas-fired heating and cooling systems to more energy-efficient electric systems. The funds are typically allocated for capital investments related to sustainability improvements.

  On the other hand, Sustainability-Linked Loans are broader in their scope. They can be structured to incentivise hotel businesses to achieve sustainability targets and goals, so are suited to operating assets and to a wider ESG business strategy. Hotel brands such as Citizen M have taken advantage of them to assist them in achieving their goal of minimising their impact on the environment and embedding sustainability in every aspect of their operational business. The loan terms and interest rates are directly linked to the hotel's sustainability performance and achievements. The loan is tied to measurable sustainability metrics, such as carbon emissions reduction, energy efficiency improvements, or achieving recognised sustainability certifications.

- **Loan Structure**: Green Loans are structured as traditional loans, where the borrower borrows a specific amount of money and repays it over time with interest. The upfront benefit of a Green Loan is the availability of funding, as banks, funds and alternative lenders often have specific 'ringfenced' green finance to deploy once a borrower's 'green purpose' has been established. The pricing can also be preferential to a traditional loan, but not currently to a material extent.

  Sustainability-Linked Loans, on the other hand, have a more dynamic structure. The loan terms, including interest rates or even principal amounts, are tied to specific sustainability performance targets. These targets are agreed by the borrower (in conjunction with any business partners and operators) and the lender and are typically based on pre-determined key performance indicators (KPIs) related to sustainability. The business's performance against these KPIs will influence the loan's terms and repayment structure.

- **Performance Assessment**: Green Loans primarily focus on financing and supporting the implementation of specific sustainability projects. The assessment of the loan's success for a hotel business is based on the completion of each applicable sustainability project and the overall environmental impact achieved, such as the consequential BREEAM rating obtained.

  In contrast, Sustainability-Linked Loans have a stronger emphasis on ongoing performance assessment and reporting. Hotel businesses are required to track and report their sustainability metrics and progress against the agreed-upon targets. Regular monitoring and reporting are essential to evaluate the hotel's performance and determine any adjustments to the loan terms or incentives such as a reduced margin on interest payments.

- **Benefits:**
  - Positive publicity – with sustainability as the Real Estate industry's top priority across all of its sectors, green financing is a way for businesses to promote their green credentials.
  - Preferential interest rate – borrowers could benefit from lower interest rates or conditional lower interest rates than traditional finance.
  - Marketability – hotel businesses with an ESG strategy or green initiatives are likely to be more appealing to customers, investors, partners and financiers.
  - Efficiency – operational costs may be reduced by the green initiatives financed, e.g. lower heating costs, lower carbon footprint.

In summary, green financing can create additional funding opportunities for businesses within the hotel industry. Compared to traditional lending it is likely to involve more management time, both in terms of establishing the green parameters and then the ongoing reporting and administrative obligations. However, once the framework has been established, the ongoing monitoring and accountability is likely to yield a more efficient business that is appealing for customers as well as investors and business partners.