

Developments in Sustainability-Linked Perpetuals

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Sustainability-Linked Perpetuals (SLPs) are a type of financial instrument that combines traditional perpetual or hybrid bonds with sustainability-linked coupons.[1] Historically not many have been issued (see Table 1), as step-up coupons often render these structures ineligible for equity treatment from major rating agencies (S&P, Moody's, and Fitch), which reduces their utility to issuers.[2] Indeed, the Moody's rated 2022 issuance from Ampol, an Australian petroleum company, is the only SLP that received equity treatment from one of these agencies of which we are aware.[3]

However, in the last two months there has been favourable movement by Asian rating agencies toward SLPs. In October, Sunway REIT (ticker SREITP), a Malaysian Real Estate Investment Trust (REIT), priced two SLPs that received 75% equity treatment from RAM Rating Services Berhad, the largest credit rating agency in South-East Asia (ASEAN).[4] Earlier, in September, Fuyo General Lease (ticker FUYOGN), a Japanese REIT, issued a bond that received 50% equity treatment from two Japanese agencies, JCR and R&I. This followed a favourable treatment of another SLP structure from Daiwa House (ticker DAIWAH) in April 2024.

Adding sustainability-linked features to debt provides a hedge for investors against poor sustainability performance. Finding ways to incorporate such features into corporate hybrid issuances would increase transparency and accountability around sustainability objectives.

Table 1. Sustainability-Linked Perpetual bonds in non-CNY currencies (SUNREIT details estimated). Source: Bloomberg, accessed 15 Oct 2024.

Issuer	Ticker	ISIN	Pricing Date	Sector	Currency	Size	Rating
VOSSLOH AG	VOSGR	DE000A3H2VA6	15-Feb-21	Industrial	EUR	150,000,000	
UBM DEVELOPMENT AG	UBSAV	XS2355161956	11-Jun-21	Consumer, Cyclical	EUR	100,000,000	
AMPOL LTD	ALDAU	AU3FN0069704	15-Jun-22	Energy	AUD	150,000,000	Moody's
ELTEL AB	ELTEL	SE0019914250	30-Mar-23	Communications	EUR	25,000,000	
STT GDC PTE LTD	STTGDC	SGXF26579122	08-Jan-24	Communications	SGD	500,000,000	
DAIWA HOUSE IND CO LTD	DAIWAH	JP350500AQ44	12-Apr-24	Consumer, Cyclical	JPY	60,000,000,000	JCR /R&I
FUYO GENERAL LEASE	FUYOGN	JP382627AQ94	10-Sep-24	Financial	JPY	20,000,000,000	JCR/R&I
SUNREIT	SREITP		15-Oct-24	Financial	MYR	350,000,000	RAM
SUNREIT	SREITP		22-Oct-24	Financial	MYR	150,000,000	RAM

[1] For more details on the Sustainability-Linked Bond Market please see "Sustainability-Linked Bond Handbook", AFII, May 2024.
[2] For analysis on an unrated issuance from a Singaporean data centre please see "STT GDC issues a Sustainability-Linked Perpetual", AFII, 23 Jan 2024.
[3] "Ampol Announces Sustainability-Linked Hybrid Issue", Fixed Income News Australia, 17 Jun 2022.
[4] This confirmation was given to us directly from RAM. Its general product guidance can be downloaded from https://www.ram.com.my/ratings/ titled "Equity Credit for Corporate Hybrid Securities".

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Sustainability-Linked Perpetuals

Sustainability-Linked Perpetuals (SLPs) are a type of financial instrument that marries sustainability-linked features with perpetuals or hybrids bonds.

Traditional bonds have set repayment dates on which the principal is paid back to investors. These instruments pay out fixed coupons periodically between issuance and maturity.

A Sustainability-Linked Bond (SLB) is a security that pays a fixed or floating coupon, the size of which increases or decreases by a predetermined amount at a specific point during its term, based on whether the issuer meets Sustainability Performance Targets (SPTs). Step-up coupon structures, where payments increase if and when SPTs are missed, are typical.[1]

In contrast, a perpetual/hybrid bond is a debt instrument which has elements of both conventional debt and equity. They typically have very long, or even never-ending maturities (hence 'perpetual'). The issuer pays fixed coupons to bondholders indefinitely or until the bond is called (redeemed). Perpetuals/hybrids are typically subordinated in the issuer's capital structure, and thus have equity-like loss features. Due to their long-dated and subordinated nature, perpetual/hybrid bonds are often classified by rating agencies as part debt and part equity.

A key reason companies issue these structures is because of this dual treatment. According to the International Financial Reporting Standards (IFRS), they can sometimes be accounted as equity liabilities.[5] This means companies can potentially issue them to access more financing without impacting their debt-to-equity ratios and worsening their credit ratings.

Rating agency treatment

The lack of rated SLPs is likely due to the coupon step feature of these instruments and how this affects the hybrid classification.

As per their white paper in 2020, S&P take the view that any SLPs with a step-up coupon lose their equity treatment, as increased interest charges occur when sustainability performance and creditworthiness has deteriorated.[6]

Fitch and Moody's are potentially more flexible relative to S&P. They note that an equity treatment for SLPs may be possible, although this depends on the exact details of the coupon step-up.[7] Indeed in 2022, Ampol LTD, an Australian petroleum company, issued a sustainability-linked subordinated convertible note worth A$150mm, a type of SLP. Moody's granted the security 50% equity/credit treatment and rated the note Baa3 despite the penalty for missing SPTs increasing the redemption price of the note to 101%.[8,9]

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[5] "Issuance of hybrid debt instruments and so-called contingent convertible bonds (CoCo)", Clifford Chance, Aug 2016.
[6] "Sustainable Finance: Equity Content And Sustainability-Linked Hybrids", S&P Global, 10 Feb 2020.
[7] As reported in "The missing market: sustainability-linked hybrids", GlobalCapital, 11 Jan 2024.
[8] "HSF debt capital market experts advise Ampol on issue of A$150m sustainability-linked hybrid", HSF, 30 Jun 2022.
[9] Note there are also adjustments to the conversion price depending on whether the SPT is achieved or missed, as detailed in "Ampol Announces Sustainability-Linked Hybrid Issue", Fixed Income News Australia, 17 Jun 2022.

Asian Rating Agencies

There is evidence that some Asian rating agencies are taking a more accommodative approach to SLPs.

Japan

The Japanese Credit Rating Agency (JCR) views step-up coupons as separate from its three equity assessment requirements: flexibility of interest payment, permanence of principal, and subordination upon bankruptcy.[10] Instead, they see coupon adjustments as purely an incentive for more sustainable practices.[10]

Similarly, Rating and Investment information Inc (R&I), another Japanese rating agency, has three equity assessment requirements for hybrids, similar to JCR's: term to maturity, deferral of interest/dividend payments, and priority of claims following bankruptcy.[11] None of these are concerned with whether a coupon amount varies over an instrument's term.

JCR and R&I have provided equity treatment to two SLPs (as shown in Table 1).

The first was issued by Daiwa House Industry Co., Ltd, a Japanese real estate company. This bond received 50% equity treatment from JCR and R&I.[12]

The second was issued by Fuyo General Lease, a Japan-based leasing company, in Sep 2024, and also received 50% equity treatment from JCR and R&I.[13]

Malaysia

RAM Rating Services Berhad, a Malaysian rating agency and the largest in ASEAN, evaluates equity credit on the basis of whether three characteristics are met: no maturity, no ongoing payments, and loss absorption. The rating agency categorises debt that is determined to be hybrid into one of five baskets, ranging from 100% debt treatment in basket A to 100% equity in basket E.[14]

Based on these criteria, Sunway REIT's recent SLPs were potentially eligible for equity treatment due to their deeply subordinated nature, risk of deferred profit payments, and unfixed maturity date. A 75% equity treatment for the securities was confirmed by AFII directly from RAM, alongside an overall rating two notches below SUNREIT's long-term rating.[15]

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[10] "Requirements for Equity Content for Sustainability-Linked Hybrid Financing—Changes in Economic Conditions Linked to SPTs Do Not Affect Equity Content Assessment", JCR, 5 Sep 2022.
[11] "Evaluation of Equity Credit Attributes of Hybrid Securities and Rating Perspectives", R&I, 11 Jun 2021.
[12] JCR confirmation is detailed in "Daiwa House Industry Co., LTD Subordinated Bonds Rating", JCR, 12 Apr 2024. R&I treatment was confirmed directly and the source provided was "Daiwa House Equity Evaluation News Release", R&I, 22 Mar 2024 which is in Japanese.
[13] JCR confirmation is detailed in "Fuyo General Lease Co., Ltd. Subordinated Bonds Rating", JCR, 10 Sep 2024. R&I treatment was confirmed directly, and the source provided was "Fuyo Equity Evaluation News Release", R&I, 19 Aug 2024 which is in Japanese.
[14] General product guidance can be downloaded from https://www.ram.com.my/ratings/ titled Equity Credit for Corporate Hybrid Securities.
[15] "RAM Ratings affirms AA2 rating of Sunway REIT, A1(s) and P1(s) ratings of debt facilities issued by its funding conduits", RAM Ratings, 9 Aug 2024.

Conclusion

Including sustainability-linked elements into perpetual or hybrid debt has the potential to improve accountability around sustainability objectives.

However, coupon step-ups, which increase interest costs for borrowers in the event of missed sustainability targets, have led some rating agencies to withhold equity treatment from SLP structures. This may be a key reason why few sustainability-linked hybrids have been issued.

However, recent developments suggest the SLP product is being received more favourably by certain rating agencies.

A recent deal from Sunway REIT, a Malaysian property trust, has received 75% equity treatment from RAM, the biggest ratings agency in Southeast Asia. This builds on issuance in Japan by Daiwa House and Fuyo, which were both given 50% equity treatment from JCR and R&I, and a small SLP issued by Ampol, an Australian petroleum company, which was also given 50% equity treatment by Moody's.

These deals challenge the idea that a small coupon step-up meaningfully impacts the permanence of issued debt with hybrid/perpetual characteristics, and may encourage the major global rating agencies to reconsider their approaches. Such a shift could precipitate significant growth in SLP issuance.

Appendix – Details of DAIWAH SLP

Daiwa House Industry Co Ltd. is a Japanese real estate company specialising in the construction of housing. It is part of the Daiwa House Group.[16] Daiwa House Industry has shown commitment to sustainable finance in the fixed income space, and currently has 140-billion-yen worth of labelled debt outstanding. AFII is aware of one SLP, two SLBs, and one green bond that it has issued.[17,18]

The second party opinion on Daiwa House Industry's sustainability-linked finance framework states that it is aligned with the principles and guidelines from key international organisations, including the International Capital Markets Association (ICMA) and the Loan Market Association (LMA).[16]

The largest of these issuances, worth 60 billion yen, was the SLP issued on 12 Apr 2024 with a maturity date of 25 Sep 2059.[19] The SLP has an initial interest rate of 1.270% and can be redeemed early five years after issuance. It has a credit rating of A+ from JCR and A from R&I.[12,19]

The SLP has two SPTs. The first is a reduction of the rate of Scope 1 and 2 greenhouse gas emissions of business activities by 59%. The second is a decrease by 56% of Scope 3 emissions in community planning. Both targets are relative to a benchmark of FY2015.[19] The SPTs will be observed at the end of Aug 2028.[12,19]

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[16] "Daiwa House Industry Co., Ltd. Sustainability-Linked Finance Framework", R&I, 22 Mar 2024.
[17] "Green Bonds Issuance List (Domestic)", accessed 07 Nov 2024.
[18] "Sustainability Linked Bonds Issuance List (Domestic)", Japanese Ministry of the Environment, accessed 07 Nov 2024.
[19] "Notice Regarding the Determination of the Issuing Conditions for the Public Offering of the Fourth Hybrid Bonds (Subordinated Bonds) (Sustainability-Linked Bonds)", FASF, 12 Apr 2024.

Failure to achieve an SPT or both SPTs will result in a donation of 0.05% or 0.1%, respectively, of the face value of the bond to organisations engaged in environmental conservation activities or the purchase of emission credits.[19]

Appendix – Details of FUYOGN SLP

Fuyo General Lease is a Japanese leasing company that covers equipment leasing, real estate leasing, and financing.[20] The company has issued multiple labelled debt instruments in pursuit of its sustainability objectives.[21] It currently has four SLBs, one sustainability bond, and two green bonds outstanding, worth a combined 102 billion yen that AFII is aware of. These were issued between 2018 and 2024.[17,18,22]

Fuyo's most recent issuance was on 10 Sep 2024. On this date, it issued an SLP valued at 20 billion yen, with an initial interest rate of 1.920%.[13] The perpetual has a maturity date in 2059 and an option for early redemption in 2029, five years after issuance. It has a credit rating of A from JCR and A- from R&I.[13]

The SLP is linked to two SPTs. The first aims for a cumulative investment of 226 billion yen in decarbonisation efforts between FY2022 and FY2026, while the second SPT targets a 300% increase in spending on human resource development by FY2026, compared to FY2021.[13]

The SPT observation date is 31 Aug 2027. The increase or decrease in interest rate will be determined at the discretion of Fuyo General Lease and will persist until the bonds are redeemed.[13]

Appendix – Details of SREITP SLP

Sunway REIT is one of Malaysia's largest Real Estate Investment Trusts (REIT) and is part of the Sunway group, a leading conglomerate in Southeast Asia.[23] The REIT has made considerable progress on sustainability and climate actions within the fixed income space. For example, in 2023 97.5% of its borrowings were structured using a sustainable finance mechanism.[24]

In 2021, Sunway REIT became the first Malaysian company to issue a Sustainability-Linked Medium Term Note (SLMTN). This also made it the first Malaysian REIT to incorporate sustainability into its capital management strategy.[24]

In June 2023, Sunway REIT also executed its first Sustainability Cross Currency Swap, valued at MYR 200mm.[25] This trade constitutes a Sustainability-Linked Derivative, details of which are often not made public by other parties. This transparency signals further commitment by Sunway REIT to its KPI-linked instruments.

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[20] "Overview of the Company | About Us", Fuyo General Lease Co., Ltd., accessed 04 Nov 2024.
[21] "Fund Procurement through Sustainable Finance", Fuyo General Lease Co., Ltd., accessed 04 Nov 2024.
[22] "Outline of Sustainability Bond (Fuyo CSV Bond) | Fund Procurement through Sustainable Finance", Fuyo General Lease Co., Ltd., accessed 07 Nov 2024.
[23] "An Overview of Sunway REIT", Sunway REIT, accessed 04 Nov 2024.
[24] "Sustainability Overview", Sunway REIT, accessed 04 Nov 2024.
[25] "How is Sunway REIT supporting the decarbonisation of Asia's real estate?", HSBC, 5 Sep 2023.

The issuer's Sustainability-Linked Finance Framework (SLFF) was rated Gold by RAM sustainability Sdn, the Sustainability arm of RAM Ratings Berhad, with all bond details considered 'aligned' and reporting and verification processes considered 'strong'.[26]

Sunway REIT issued its SLPs from SUNREIT Perpetual Bond Bhd (ticker SREITP), another wholly owned subsidiary of Sunway REIT.

These instruments have two SPTs. The first is to increase renewable energy generation by 2% annually from a baseline year of 2022. The second is to reduce building energy intensity (BEI) annually by 0.5% from a baseline year of 2019.[27] Both SPTs will be observed every year after the end of the financial year on Jun 30, starting in 2025.[27]

If, and only if, both SPTs are missed, the issuer must allocate five basis points per annum of the face value of the SLPs to a liability account. This will be used to finance green building accreditations, purchase green or renewable energy, and upgrade low-carbon assets once the bonds are redeemed.[27]

The SLPs are valued at MYR 500mm with a coupon rate of 4.51% and 4.68% per annum. They can be called after five and seven years after issuance, respectively.[27]

[26] "Second-Party Opinion Report Sunway Real Estate Investment Trust", RAM Sustainability, 23 Aug 2024.
[27] "Pricing Supplement SUNREIT PERPETUAL BOND BERHAD", financialmarkets.bnm.gov.my, 15 Oct 2024.

Version Log

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12 Nov 2024	Document published
4 Dec 2025	Additional link added (footnote 9) on Ampol SLP, with details of conversion price change in the event of missed SPT

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