



Sustainability | Leadership | Innovation



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Xylem Inc.: a new financing model that ties cost of capital to sustainability

Finalist: Innovative project award

What

Xylem Inc. is a global water technology company that develops technology solutions to address the world's water challenges. Sustainability is a core business issue at Xylem, and it has committed to a set of sustainability goals. In 2019, Xylem pioneered a new approach to combining sustainability and financing with a sustainability-linked revolving credit facility. The interest rate is index-linked to Xylem's sustainability performance, which is independently rated each year by Sustainalytics, a leading provider of environmental, social and corporate governance (ESG) ratings.

This innovative financing mechanism directly ties Xylem's financial objectives to its sustainability goals. The project is designed to further incentivise centring and integrating sustainability across the global organisation. Xylem will benefit from lower interest rates for sustainability improvements, but also bear the cost of higher interest rates if sustainability performance slips. The size of this revolving credit facility is US\$800 million with the ability to increase it to US\$1 billion, making this a significant commitment at 15-19% of Xylem's 2019 revenues and around one third of Xylem's total 2019 borrowing.

For Xylem, this project has raised the bar for its accountability on sustainability. Sustainalytics ratings primarily use publicly available information, creating an incentive for Xylem to make its sustainability performance and related policies transparent. By creating a financial downside risk to failing to meet sustainability goals, Xylem has also ensured that its shareholders will hold it to account on sustainability.

Why

Xylem specialises in developing technology for the purpose of 'solving water' and understands the importance of water in creating a sustainable world. Xylem believes that it therefore has the position, and so the responsibility, to create real change by making sustainability central to its business and strategy. To this end, Xylem launched a set of ambitious sustainability goals for 2025, in line with the UN Sustainable Development Goals.

Xylem's finance team proactively designed this innovative project to align its work with the company's sustainability goals and to reinforce those goals. The project creates a real financial incentive for the company to advance sustainability from a strong base.

The terms of the loan were built to set a high standard for sustainability improvements. The targets are intentionally challenging: to start receiving a financial benefit, Xylem must improve its Sustainalytics rating from 78 – already high – to a score of 81. The Sustainalytics rating touches every aspect of Xylem's work, demanding a concerted, directed and integrated effort across all areas of the global company – which is what Xylem aims to achieve.



'What the loan does is provide another incentive to the company to say that, if we drive these [sustainability goals], we're actually going to get a benefit. We all want to do social good, but to do social good you do need to have an economic impact as well, and this will help provide that.'

Samir Patel,
Corporate Vice President and Treasurer, Xylem

How

Xylem's finance team spent over a year developing its financing project proposal with the support of the sustainability group. The steps taken to design and implement the project were as follows:

- > Having conceived the idea for a new type of financing, Xylem **reviewed the market** to assess the appetite for a sustainability-linked revolving credit facility.
- > The finance team **selected 12 banking partners** that were aligned with Xylem's mission and vision around sustainability. To many, the concept was novel. The finance team worked with banks to discuss how such a facility could be structured and priced.
- > Xylem and its banking partners **developed variable pricing in line with targets**, with both upside and downside risk. To add as much rigour as possible, pricing would be linked to annual independent ESG ratings. Sustainalytics was selected to provide ratings because of the comprehensiveness of its ESG approach.
- > To integrate the project with existing goals, Xylem's finance team **collaborated with the sustainability group**. Together, finance and sustainability reviewed and determined specific ESG targets and worked to raise awareness across the company.
- > The team **sought management buy-in**. The CEO and senior management team had already prioritised sustainability and accepted the potential financial impact of this project.
- > The project team **involved staff across the organisation**. The broad scope of the Sustainalytics ESG ratings meant that the performance of every functional area in the company and every part of the business would be critical to achieving the project targets.
- > The team **agreed sustainability priorities** with each functional area, backed up by specific metrics. These were linked to Xylem's 2025 sustainability goals and the Sustainalytics targets. Regular monitoring meetings are held and corrective action plans put in place where needed.
- > To ensure transparency, Xylem **will report its sustainability impact** in its annual report. A separate **sustainability report** is available on Xylem's website, listing its 2025 sustainability goals and the company's progress towards achieving them.
- > Xylem **engaged its investors** in the process. The company has received positive feedback from investors for linking its cost of capital to sustainability. Xylem's largest investors also provided input on the company's sustainability goals.
- > Xylem has **shared its experience** of sustainability-linked financing with the investment and business communities. The company hopes that, by doing so, other organisations will emulate its approach.
- > In the future, the finance team is keen to align all financing to Xylem's sustainability performance. While revolving credit facilities will be part of that picture, the team also hopes to **diversify its financing** with other sustainable finance options, such as green bonds.

www.xylem.com



DISCLAIMER

This case study presents Xylem Inc. entry for the Finance for the Future Awards 2019. The case study only includes information that was part of the organisation's 2019 entry. Some of this information may now be out of date. For a current view of the organisation's work, please visit their website at the link given above.



'Xylem's commitment to improve its own performance on ESG is impressive. Its sustainability-linked \$800m five-year revolving credit will be assessed independently by Sustainalytics. This new approach, one of the first of its kind globally, is creating real internal alignment with its sustainability goals and is attracting positive interest from both investors and business.'

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