STT GDC issues a Sustainability-Linked Perpetual

Josephine Richardson (*)

On 8 Jan 2024, STT GDC (ticker STTGDC), an unrated Singaporean data centre provider, priced SGD450mm ($0.3bn) of a Sustainability-Linked Perpetual (SLP) at a yield of 5.7% (ISIN SGXF26579122),[1] a structure rarely seen in the sustainability-linked debt market. This bond has no maturity, although is callable from Jan 2030. The KPI, measuring the percentage of energy consumption from renewable sources, will be observed on 31 Dec 2026.

Sustainability-linked debt, where a coupon is usually linked to performance against a sustainability target, is typically issued in bullet form. Corporate hybrids make up around 20% of the Euro high-yield bond market,[2] but SLPs are just 1% of the unrated Euro SLB market, and so this new deal is significant in an embryonic market.[3]

We explore the reasons for the low take-up of sustainability-linked hybrids and review this transaction in terms of structure and pricing.

- **STT GDC, a sovereign-wealth fund owned data centre provider, seems committed to sustainable financing. This issuance offers a chance to improve transparency and dialogue with a privately-owned company.**
- **This bond has much to commend it. The renewables KPI is relevant for the issuer, and the target requires ongoing improvements against a backdrop of a growing business. The step-up, however, does not meet the materiality required to be classified as a 'greenback' SLB.**[4]
- **This bond is not just rare as a perpetual, it also extends the market in SGD-denominated securities and amongst wireless telecoms issuers. This helps broaden the offering of sustainability-linked products for investors.**
- **Corporate hybrids form a significant portion of the high-yield and unrated bond market. Rating agency treatment has likely impeded the take-up of sustainability-linked hybrids, and we believe any major global rating agency confirming eligibility of equity treatment could catalyse the growth of this product.**

---

[1] "STT GDC Issues S$450M Sustainability-Linked Perpetual Securities to Drive Sustainability Initiatives and Fuel Global Expansion", STT, 10 Jan 2024.
[2] "Hybrid bonds as solid components of high-yield portfolios", Swiss Life, 26 Oct 2023.
[3] We see 24 SLPs issued to-date (as shown overleaf in Table 2), with a total size of $3.9bn, all from unrated issuers. Only four are not in CNY: three small bonds in EUR totaling $0.3bn, and the new deal from STT GDC. Total unrated SLB issuance in EUR is $32.1bn according to Bloomberg as of 17 Jan 2024.
[4] For full details of this minimum materiality proposal please see "Greenback SLBs: an impact standardisation proposal", AFII, 10 May 2023.

(*) Anthropocene Fixed Income Institute (www.anthropocenefii.org). Author for contacts: jor@anthropocenefii.org

Introduction

Hybrid bonds, debt instruments either with a very long maturity or no maturity (a perpetual bond / perp), combine elements of conventional debt and equity. From a debt point of view, they typically have fixed coupons and a set capital repayment. They look like equity due to long or no maturity and subordinated position in the capital structure.

The benefit of issuing such structures is derived from their accounting treatment; for example if certain conditions are met, hybrid instruments can be accounted for as an equity liability under the International Financial Reporting Standards (IFRS), which may improve balance-sheet ratios.[5] Rating agencies also often consider the liabilities as 50:50 equity-to-debt and so this can be an efficient way to raise debt capital without suffering a rating downgrade.[5]

Rating treatment

S&P has been very clear that any step-up coupon included in a perpetual bond would remove its equity treatment.[6] This is driven by an assumed correlation between missing sustainability targets, and credit deterioration.

"We could consider failure to meet a sustainability target to be a constraint to the issuer's creditworthiness, even if the overall impact is marginal and does not lead to a downgrade or outlook revision. [...] If the cost of servicing the hybrid, or the likelihood of redeeming it, increases in response to deterioration of the issuer's creditworthiness, we would assess the hybrid as having no equity content."[6]

A belief that sustainability performance impacts creditworthiness is core to our risk-management work related to SLBs, i.e., that the step-up provides a hedge to protect against any related price deterioration driven by weakening credit.[7]

Step-down structures, or an alternative payment such as a charitable donation,[8] could be a solution. But for the moment, S&P is resolute in its view.[9]

Fitch and Moody's are reported to be more flexible in considering equity treatment for SLPs,[9] depending on the size of the coupon step-up. The Japanese Credit Rating Agency has offered a more positive approach; that step-up coupons primarily provide incentives to improve sustainability and are separate from its requirements for an equity assessment.[10] Indeed, it also provided an equity content assessment for large Sustainability-linked Loan Hybrids, although we have been unable to confirm the issuance of that debt.[11]

Nevertheless, we note that all SLPs issued to date are from unrated corporates (please see Table 2 in the Appendix), and view rating agency treatment as a key obstacle to market growth.

---

[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, 10 Feb 2020.
[7] This is discussed further in "Understanding dynamics between sustainable and traditional debt", AFII, 16 Jan 2023.
[8] We discuss this more in "Sustainability-Linked Bonds: alternative steps", AFII, 25 May 2023.
[9] As reported in "The missing market: sustainability-linked hybrids", GlobalCapital, 11 Jan 2024.
[10] "Requirements for Equity Content for Sustainability-Linked Hybrid Financing", JCR, 5 Sep 2022.
[11] "The Chugoku Electric Power Company Subordinated Loan Rating", JCR, 29 Jun 2022.

STT GDC bond details

STT GDC is a Singaporean data centre provider, with over 170 data centres across Asia and the UK. It is wholly owned by ST Telemedia, a direct and wholly-owned subsidiary of Temasek Holdings, Singapore's sovereign wealth fund.

STT has three bonds outstanding (as shown in Table 1). Prior to this hybrid issuance, it had two bullet bonds, one of which matures this year. As a privately-owned issuer, the debt markets are the only point of engagement from investors.

Table 1. STT GDC bonds. Source: Bloomberg, accessed 18 Jan 2024.

Description	ISIN	Issue Date	Maturity	Currency	Amount Outstanding
STTGDC S$5.7 PERP	SGXF26579122	15-Jan-24		SGD	450,000,000
STTGDC S$3.1 28s	SGXF85905275	28-Jul-20	28-Jul-28	SGD	400,000,000
STTGDC S$3.5 24s	SGXF20920694	26-Sep-19	26-Sep-24	SGD	225,000,000

STT GDC released its Sustainability-Linked Financing Framework (SLFF) in Jul 2022 with three KPIs.[12] KPI1 is the percentage of electricity consumed from renewables, KPI2 the carbon intensity of STT GDC operations, and KPI3 the proportion of data centres that are classified as Green buildings.

The Second Party Opinion (SPO), provided by Sustainalytics, rated only the first as 'strong',[13] and only this KPI was chosen for the ultimate issuance in Jan 24.

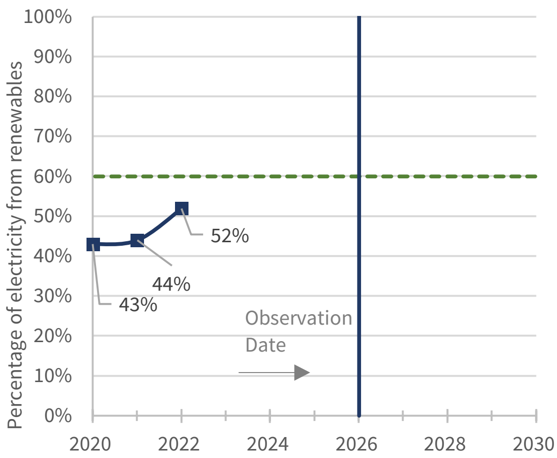
STT GDC KPI analysis

The Sustainability Performance Target (SPT) is to increase the percentage of electricity that it uses from renewable sources from 43% in 2020 to 60% in 2026. Figure 1 shows the reported data; the latest figure of 52% for 2022 comprises a total of 878 GWh of 'carbon-free electricity'.[14]

An additional renewables-focused Power Purchase Agreement (PPA) was signed in 2023 with O2 power, an Indian renewable energy platform, to supply STT GDC India.[15]

Any trend of higher renewables usage has to be considered alongside STT GDC's business

Figure 1. STT GDC historic renewable energy usage. Source: STT GDC.



[12] "STT GDC Pte Ltd Sustainability-Linked Financing Framework", STT GDC, Jul 2022.
[13] "Second-Party Opinion STT GDC Pte Ltd Sustainability-Linked Financing Framework", Sustainalytics, 4 Jul 2022.
[14] Please see page 32 of "STT GDC ESG Report 2022", STT GDC, accessed 18 Jan 2024.
[15] "STT GDC India Partners O2 Power for the Supply of Renewable Energy to Data Centre in Bengaluru", STT GDC, 31 Jan 2023.S

growth.[16] From 2021 to 2022, STT GDC's total energy usage increased 22%, its absolute renewable procurement increased 45%, which combined to achieve the 8% rise in the KPI.[14]

In general, the recent trend of increase though, would suggest that the SPT is relatively achievable.

STT GDC SLP pricing

A bullet SLB step-up coupon can be priced as a binary option using the probability of the target being missed as an input into the model.[17]

When the underlying instrument is a perpetual, that adds a dimension of complexity into the pricing. Corporate hybrids are typically called at the first opportunity,[18] and if not there is usually a coupon step-up to compensate investors, and the bond typically loses its equity content.[19] In this example, the STT GDC hybrid coupons step up 100bp if not called, so we will price the bond to the first call date.

The unadjusted coupon is 5.7%, and the step-up coupon, of 25bp, is potentially paid for the final two and a half years.[20] Even before considering a credit-risky discounting we can see this is not a material step-up. Using risk-free discounting and an illustrative 50% probability of missing the target, the total value is calculated to be worth 0.28%, well below the threshold needed to be considered a 'greenback SLB'.[4]

When modelling the variables, a renewables KPI is more complicated than one that is emissions-based. Historical data is generally scarcer, changes are typically more discontinuous driven by new infrastructure or contractual arrangements, and dynamics change when the variable is close to 0 or 100%. Here, due to very limited prior data, we estimate the probability of missing the target as 25%. The trend is to meet the target some years ahead of observation date, and there are news stories suggesting additional renewable power has been sourced. However, the ongoing growth of the business adds some uncertainty.

Using a 25% probability of missing the target, we calculate the total upfront value of the option to be 0.14%, which is 2.5bp running to first call date. In the context of a subordinated bond priced at a spread of 298bp, this is immaterial.[20]

STT GDC's CFO has reported that it was hard to identify a direct benefit to pricing from the sustainability features, however he feels it definitely contributed to a stronger execution process.[20]

---

[16] STT GDC is expanding its business, for example "ST Telemedia GDC India to invest $1 bn in expanding data centre capacity in India", The Hindu Business Line", 8 Sep 2023.
[17] For full details of our pricing framework please see "An option pricing approach for Sustainability-Linked Bonds", AFII, 8 Nov 2022.
[18] "7 Questions To Understand Corporate Hybrid Bonds", BNP Paribas Wealth Management, 16 Nov 2021.
[19] "Corporate Hybrids: Yield and visibility", Groupama Asset Management, 27 Nov 2023.
[20] "Sustainable financing 'a must-have' says hybrid SLB issuer", GlobalCapital, 17 Jan 2024.

Conclusions

STT GDC's entry to the sustainability-linked debt market increases transparency and engagement for a privately-owned company. Embedding sustainability objectives in debt increases dialogue and accountability for those targets.

This is only the fifth issuer in the sustainability-linked market in SGD,[21] and the seventh in the "Wireless Telecommunications Services" industry,[22] and so this issuance also helps to broaden the offering for investors.

Reviewing issuance in sustainability-linked hybrid form shows that it is limited to unrated issuers so far. No major global rating agency has given comprehensive reassurance that they would consider an SLP for equity treatment, although Moody's and Fitch may be receptive to such discussions.

In the words of the STT GDC's CFO, "*Sustainable financing is becoming a must-have rather than a nice-to have".*[20]

This bond has been effective at broadening the use of sustainability-linked debt to a private company, in a currency and sector with limited sustainable issuance and using a structure very popular with corporate issuers that is rarely seen with sustainable features. This is hopefully indicative of the market becoming more comfortable with sustainability-linked structures.

---

[21] Others are Nanyang Tech University, Sembcorp, Ascott Reit Mtn Pte Ltd and Surbana Jurong Pte Ltd. Source: Bloomberg accessed 19 Jan 2024.
[22] Others are Tele2 AB, Koninklijke KPN NV, Liberty Costa Rica, Telus, Inteno Group and Orange. Source: Bloomberg, accessed 19 Jan 2024.

Appendix

Table 2. Sustainability-Linked Hybrid issuance. Source: Bloomberg, accessed 12 Jan 2024.

Issuer	Ticker	ISIN	Pricing Date	Sector	Currency	Size	Rating
VOSSLOH AG	VOSGR	DE000A3H2VA6	15-Feb-21	Industrial	EUR	150,000,000	NR
UBM DEVELOPMENT AG	UBSAV	XS2355161956	11-Jun-21	Consumer, Cyclical	EUR	100,000,000	NR
CHINA HUANENG GROUP	HUANEN		23-May-22	Utilities	CNY	1,300,000,000	NR
CHINA HUANENG GROUP	HUANEN		23-May-22	Utilities	CNY	700,000,000	NR
HUANENG LANCANG HYDRO	HUANEN		06-Jul-22	Utilities	CNY	2,000,000,000	NR
CHINA RAILWAY CONSTRUCT	RLCONS	CND10006PZD5	18-Jul-22	Industrial	CNY	1,500,000,000	NR
CHINA RAILWAY CONSTRUCT	RLCONS	CND10006PZF0	18-Jul-22	Industrial	CNY	1,500,000,000	NR
JX WATER CONSERVANCY INV	JXWCIG		19-Jul-22	Industrial	CNY	1,000,000,000	NR
HUANENG POWER INTL INC	HNINTL		22-Jul-22	Utilities	CNY	2,000,000,000	NR
CRBC INTERNATIONAL	CRBCIN		18-Aug-22	Industrial	CNY	1,000,000,000	NR
CCCC FIRST HIGHWAY ENGIN	CCCCFH		28-Sep-22	Industrial	CNY	1,000,000,000	NR
PINGDINGSHAN TIANAN COAL	PINGMI	CND10005YP70	12-Dec-22	Energy	CNY	800,000,000	NR
ELTEL AB	ELTEL	SE0019914250	30-Mar-23	Communications	EUR	25,000,000	NR
WUXI INDUSTRY DEVELP	WUXIND	CND10006C8X3	17-Apr-23	Consumer, Cyclical	CNY	500,000,000	NR
KNOWLEDGE CITY INV GROUP	KCGZIG	CND10007B5T7	12-Jun-23	Financial	CNY	1,000,000,000	NR
JIANGYIN PUBLIC ASSET	JYCPAM	CND10006T941	21-Jul-23	Industrial	CNY	700,000,000	NR
DATANG SICHUAN POWER	DTSCPW	CND10006XLZ2	15-Aug-23	Utilities	CNY	500,000,000	NR
DATANG SICHUAN POWER	DTSCPW	CND10006XM08	15-Aug-23	Utilities	CNY	500,000,000	NR
SHANDONG HI-SPEED GROUP	SDEXPR	CND10007BGF8	23-Aug-23	Industrial	CNY	1,500,000,000	NR
SINOHYDRO 11 BURE CO	SINOHY	CND10006Z9H7	01-Sep-23	Industrial	CNY	700,000,000	NR
JIANGSE REGUARANTEE GRP	JSREIN		10-Nov-23	Financial	CNY	1,000,000,000	NR
JIANGXI PROVINCE INV GRP	JXPIVG		28-Nov-23	Industrial	CNY	2,000,000,000	NR
CHINA CONST 3RD ENGINEER	CCTEJS		19-Dec-23	Industrial	CNY	1,200,000,000	NR
STT GDC PTE LTD	STTGDC		08-Jan-24	Communications	SGD	450,000,000	NR

IMPORTANT DISCLAIMER:

This report is for information and educational purposes only. The Anthropocene Fixed Income Institute ('AFII') does not provide tax, legal, investment or accounting advice. This report is not intended to provide, and should not be relied on for, tax, legal, investment or accounting advice. Nothing in this report is intended as investment advice, as an offer or solicitation of an offer to buy or sell, or as a recommendation, endorsement, or sponsorship of any security, company, or fund. AFII is not responsible for any investment decision made by you. You are responsible for your own investment research and investment decisions. This report is not meant as a general guide to investing, nor as a source of any specific investment recommendation. Unless attributed to others, any opinions expressed are our current opinions only.

Certain information presented may have been provided by third parties. AFII believes that such third-party information is reliable, and has checked public records to verify it wherever possible, but does not guarantee its accuracy, timeliness or completeness; and it is subject to change without notice.

Any reference to a company's creditworthiness or likelihood of positive or negative performance in the current or future market is purely observational and should not be taken as a recommendation or endorsement or critique of such company or security.

AFII is a non-profit organisation "to monitor, advocate for and influence the impact of the fixed income and bond markets in the age of human induced climate change". For more information about the Institute, please visit www.anthropocenefii.org.

AFII is not in any way associated with, nor are any of its directors, employees or advisors, any of the companies it references in its materials or reports and is not receiving compensation or consideration of any nature for its observations and/or insights.