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Second Party Opinion

Verd Boligkreditt's Green Bond Framework

Sept. 25, 2023

Location: Norway

Sector: Banking

Alignment With Principles

Aligned = ✓ Conceptually aligned = ○ Not aligned = ✗

- ✓ Green Bond Principles, ICMA, 2021 (with June 2022 Appendix 1)

See Alignment Assessment for more detail.

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Light green

Activities representing transition steps in the near-term that avoid emissions lock-in but do not represent long-term low-carbon climate resilient solutions.

Our [Shades of Green Analytical Approach](#) >

Strengths

Verd demonstrates awareness of climate concerns. While its sustainability strategy is in a nascent phase, we view positively that Verd is considering how it can better incorporate climate risk screening when deciding on which mortgages to purchase.

Weaknesses

Eligibility requirements for green buildings do not exceed the regulatory minimum, except for buildings built after 2021. Buildings to be financed must be energy efficient compared with the stock of national buildings. However, the eligibility criteria fall short of representing significant steps toward a low carbon, climate resilient future.

Areas to watch

There is no harmonization between owner banks' climate risk assessments in the credit process and Verd's oversight on the process. Green loans have been and will be originated in line with the owner banks' regular credit approval processes, under which the scope of environmental and social factors are uncertain and may differ.

Exposure to physical climate risks will not necessarily be addressed in Verd's selection of green loans. Currently, such risks may be assessed by owner banks. Verd notes that it is planning to screen for such risks in the future; however, the scope and timeline is undefined. Flooding is expected to be the main climate-related weather hazard the real estate portfolio is exposed to.

Eligible Green Projects Assessment Summary

Eligible projects under Verd's green finance framework are assessed based on their environmental benefits and risks, using Shades of Green methodology.

Green buildings

 Light green

Buildings built in 2021 or thereafter, buildings built before 2021 and renovated buildings.

See [Analysis Of Eligible Projects](#) for more detail.

Issuer Sustainability Context

This section provides an analysis of the issuer's sustainability management and the embeddedness of the financing framework within its overall strategy.

Company Description

Verd Boligkreditt AS (Verd) is a covered bond issuer jointly owned by 18 savings banks in Norway. It was established in 2009 to offer the customers of the owner banks more affordable financing. Verd purchases first-lien residential mortgages and collective loans to housing cooperatives originated by the owner banks. These purchases are financed through the issue of covered bonds. Under the loan and transfer agreement with its owner banks, the mortgages are being legally transferred to Verd, but owner banks manage customer relations and maintenance of the mortgage portfolio as if they were their own. Verd and its owner banks have approximately combined Norwegian krone (NOK) 160 billion (US\$14.86 billion) in assets under management, of which NOK130 billion (US\$12 billion) is residential mortgages.

Material Sustainability Factors

Climate transition risk

Banks are highly exposed to climate transition risk through their financing of economic activities, which affect the environment. Their direct environmental impact is small compared with financed emissions and stems mainly from power consumption. Generally, policies and rules to reduce emissions could raise credit, legal, and reputational risks for banks. Positively, financing the climate transition offers a growth avenue for banks through lending and other capital market activities. In the European context, climate and environmental regulations are ambitious, and there is a strong push toward integrating sustainability considerations into the regulation of banks and financial markets.

Physical climate risk

Banks finance a wide array of business sectors that are exposed to physical climate risks. However, while climate change is a global issue, weather-related events are typically localized, so the magnitude of banks' exposure is linked to the geographic location of the activities and assets they finance. Similarly, banks' physical footprint (such as branches) may also be exposed to physical risks, which may disrupt their ability to service clients in the event of a natural catastrophe. Banks may help mitigate the effects of physical climate risks by financing adaptation projects and climate-resilient infrastructure, as well as by investing in

solutions that support business continuity in exposed geographies. Key risks in Norway relate to an increase in extreme precipitation and flooding.

Access and affordability

Banks' large impact on society stems from their role in enabling access to financial services to individuals and businesses, and in ensuring the correct functioning of payment systems. Ensuring affordable access to financial services, especially to the most vulnerable members of the population, remains a challenge for the banking industry. Structural issues such as poverty, informal economy, and lack of financial literacy partly limit access to financial services. However, banks have large opportunities to support economic development through financial inclusion, including by using new technologies.

Issuer And Context Analysis

The project category included in the financing framework, green buildings, aims to address climate transition risk, which we consider to be a key sustainability factor for Verd and its owner banks, which are 18 savings banks in Norway that mostly focus on providing mortgages. Green buildings are exposed to the impacts of climate change, therefore physical climate risk is also a relevant risk in the context of the framework.

Verd's sustainability strategy is in a nascent phase. In mid-2023, Verd launched its Sustainability Strategy, not publicly disclosed, with three focus areas: 1) to contribute to sustainable local communities, 2) to reduce greenhouse gas emissions in its loan portfolio and manage the impact from climate change, and 3) transparent corporate governance and strong corporate culture. At the same time, Verd is currently mapping its carbon footprint and plans to set emissions reduction targets by end-2024. We understand that Verd recently has acquired climate data for each property, including physical climate risk data points, such as likelihood of flooding and mudslides. In the future, Verd aims to use this data when selecting which mortgages to purchase to screen for some physical risks.

As Verd is only servicing as a covered bond structure for its owner banks, it operates in the context of owner banks' sustainability strategies, which may vary in the depth of their environmental, social, and governance (ESG) integration and their ambition and progress in addressing climate risks. We note that there is no strong coordination between the 18 banks to harmonize sustainability targets or follow a single sustainability strategy. Verd aims to engage with owner banks on the assessment of climate risks in the credit process, but concrete actions and a timeline are yet to be defined. At the same time, the lack of coordination is partly compensated by a clear definition of the buildings' category in the framework, which ensures that a single standard will be used.

Alignment Assessment

This section provides an analysis of the framework's alignment to Green Bond principles.

Alignment With Principles

Aligned = ✓ Conceptually aligned = ○ Not aligned = ✗

✓ Green Bond Principles, ICMA, 2021 (with June 2022 Appendix 1)

✓ Use of proceeds

The framework's green project category, green buildings, is shaded light green, and the issuer commits to allocate the net proceeds issued under the framework exclusively to eligible green projects. Please refer to the section Analysis of Eligible Projects for more information on our analysis of the environmental benefits of the expected use of proceeds.

Verd will allocate an amount equal to the net proceeds from instruments issued under its green bond framework to finance a loan portfolio to promote the transition to a low-carbon economy. The project category distinguishes between the green buildings that were built before 2021 and those built after 2021. It also includes renovated buildings. It excludes residential buildings that are used for leisure, such as cabins. However, we observe that the framework does not reference a look-back period for refinanced eligible projects as is recommended by the principles.

✓ Process for project evaluation and selection

Verd has established a Green Bond Committee (GBC) formed of members of the executive management, responsible for setting the criteria of eligible project and selection of the eligible projects. All loans are subject to the owner banks regular and applicable credit approval processes at the time of loan origination, before it is transferred to Verd. While this process may include some screening of ESG risks, the banks have no harmonized criteria and the scope of the screening is uncertain. This constrains Verd's ability to assess the environment and social risks that are associated with the projects financed. Some environmental risks are mitigated by Norwegian regulations, such as the Nature Diversity Act which regulates biodiversity, endangered species, and protected areas, and the Planning and Building Act which has the intention to promote sustainable development and includes requirements on the protection of valuable land.

✓ Management of proceeds

Verd commits to allocating the net proceeds from the instruments issued under its green bond framework to green loan portfolio. The allocation of the net proceeds will be tracked to ensure that they exclusively finance the eligible projects. Furthermore, under the framework, Verd will ensure that the value of the green loan portfolio exceeds, at all the times, the value of outstanding green bond. If they fail to meet the eligibility criteria, the GBC will remove and replace the projects from the green loan portfolio. Unallocated proceeds will be managed in line with the regular liquidity management policy of Verd's treasury department.

✓ Reporting

Verd commits to annual reporting on the allocation of proceeds and the impact of the green financing instrument issued under the framework and to publish the report in its website as long as these instruments are outstanding. This report will include description of the projects at the category level, the amount of debt outstanding, the share of green loans financed by green bonds, and the amount of net proceeds. In addition, the issuer will report the actual environmental impact of projects as long as the instrument is outstanding. We view as positive that the issuer will align its impact reporting with ICMA's Harmonised Framework for Impact Reporting, and that the allocation report will provide transparency on assumptions and calculation methods.

Analysis Of Eligible Projects

This section provides details of our analysis of eligible projects, based on their environmental benefits and risks, using the Shades of Green methodology.

For each financing under the framework, Verd expects to allocate all the proceeds from its first bond under the framework to green buildings.

The eligible assets will primarily include refinancing assets.

The framework excludes the financing of loans to customers linked to fossil energy extraction and/or generation, production of or research and development within weapons and defense systems, potentially environmentally negative resource extraction, gambling, pornography, or tobacco.

Overall Shades of Green assessment

Based on the project category shades of green detailed below, and consideration of environmental ambitions reflected in Verd's Green Bond framework, we assess the framework Light green.

Light green

Activities representing transition steps in the near-term that avoid emissions lock-in but do not represent long-term low-carbon climate resilient solutions.

Our [Shades of Green Analytical Approach](#) >

Green project categories

Green buildings

Assessment

Light green

Description

Loans provided to finance ownership or renovation of residential buildings, which meets either of the criteria set out below:

1. Buildings built in 2021 or thereafter:
 - Primary energy demand (PED) is 10% lower than the threshold set for the nearly-zero-energy building requirements in national measures ([veiledning-om-beregning-av-primarenergibehov-og-nesten-nullenergibygg.pdf \(regjeringen.no\)](#)). PED refers to the amount of energy needed to meet the energy demand associated with the typical uses of a building expressed in kilowatt hours per square meter (kWh/m²) per year, based on the relevant national calculation methodology and displayed on the energy performance certificate (EPC).
2. Buildings built before 2021:
 - EPC A, or alternatively, buildings within the top 15% of the national stock in terms of primary energy demand, defined as:
 - buildings built according to Norwegian building codes of 2010 (TEK10; to ensure TEK10 alignment, the issuer will use a conservative two-year time lag and include buildings built from 2012 and thereafter) or 2017 (TEK17). Using TEK10 and TEK17 will be replaced with a new national definition of “top 15%” if this is developed); or
 - EPC B for buildings built prior to 2012.
3. Renovated buildings:
 - Major renovations leading to a reduction in primary energy demand of at least 30%.

- The initial primary energy demand and the estimated improvement is based on an energy audit conducted by an independent expert. The 30% improvement results from an actual reduction in primary energy demand and is achieved through a succession of measures within a maximum of three years.
- For the full building to qualify after renovation, it should be expected to meet the criteria under #1 or #2 above.







4. Exclusions:

- Residential buildings used for leisure (cabins).

Analytical considerations

- For existing buildings, high energy performance is important to the transition to a low carbon economy. In new construction, improving energy performance and reducing emissions associated with building materials are, in our view, key topics to address from a low-carbon perspective. For all buildings, mitigating the exposure to physical climate risks is crucial to improving climate resilience.
- The criteria for existing buildings include mostly buildings only in line with regulations applicable at the time of construction (2012 to 2020.), instead of the most efficient buildings. In Norway, the top 15% of the building stock are not yet officially determined, and the framework's definition relies on a report by a consultancy. There is uncertainty as to how robust this definition of the top 15% is, although this is the best information currently available. However, Verd commits to replace its definition of "top 15%" with the new national definition if it is developed.
- For new residential buildings, the framework lacks criteria to address emissions related to building materials, which in the Nordic context typically contribute to half of a building's lifecycle emissions.
- Buildings with fossil fuel heating will not be financed. It is positive that cabins are excluded, since energy building requirements do not apply to most of these as are buildings purposely built to support energy generation with fossil fuels.
- In the transition to a low-carbon society, it is vital to renovate and improve existing properties. Renovations leading to primary energy savings of at least 30% shows a solid ambition. Verd informed us that it is still working on a technical solution with its owner banks to identify these renovation costs, therefore such projects will likely represent a small share of allocated proceeds until the methodology is developed.
- There are no specific criteria related to mitigation of physical climate risks of the financed assets. In general, buildings are highly exposed to physical climate risks, and while building regulations to some extent consider such risks, this is no guarantee that such risks are properly addressed. An increase in precipitation and flooding are key risks in the Norwegian context. Verd noted that it aims to work with owner banks to mitigate climate risk in credit assessment in the years to come; however, the scope and timeline are undefined.

S&P Global Ratings' Shades of Green

Assessments					
Dark green	Medium green	Light green	Yellow	Orange	Red
Description					
Activities that correspond to the long-term vision of an LCCR future.	Activities that represent significant steps toward an LCCR future but will require further improvements to be long-term LCCR solutions.	Activities representing transition steps in the near-term that avoid emissions lock-in but do not represent long-term LCCR solutions.	Activities that do not have a material impact on the transition to an LCCR future, or, Activities that have some potential inconsistency with the transition to an LCCR future, albeit tempered by existing transition measures.	Activities that are not currently consistent with the transition to an LCCR future. These include activities with moderate potential for emissions lock-in and risk of stranded assets.	Activities that are inconsistent with, and likely to impede, the transition required to achieve the long-term LCCR future. These activities have the highest emissions intensity, with the most potential for emissions lock-in and risk of stranded assets.
Example projects					
 Solar power plants	 Energy efficient buildings	 Hybrid road vehicles	 Health care services	 Conventional steel production	 New oil exploration

Note: For us to consider use of proceeds aligned with ICMA Principles for a green project, we require project categories directly funded by the financing to be assigned one of the three green Shades.

LCCR--Low-carbon climate resilient. An LCCR future is a future aligned with the Paris Agreement; where the global average temperature increase is held below 2 degrees Celsius (2 C), with efforts to limit it to 1.5 C, above pre-industrial levels, while building resilience to the adverse impact of climate change and achieving sustainable outcomes across both climate and non-climate environmental objectives. Long term and near term--For the purpose of this analysis, we consider the long term to be beyond the middle of the 21st century and the near term to be within the next decade. Emissions lock-in--Where an activity delays or prevents the transition to low-carbon alternatives by perpetuating assets or processes (often fossil fuel use and its corresponding greenhouse gas emissions) that are not aligned with, or cannot adapt to, an LCCR future. Stranded assets--Assets that have suffered from unanticipated or premature write-downs, devaluations, or conversion to liabilities (as defined by the University of Oxford).

Mapping To The U.N.'s Sustainable Development Goals

Where the Financing documentation references the Sustainable Development Goals (SDGs), we consider which SDGs it contributes to. We compare the activities funded by the Financing to the International Capital Markets Association (ICMA) SDG mapping and outline the intended linkages within our SPO analysis. Our assessment of SDG mapping does not impact our alignment opinion.

This framework intends to contribute to the following SDGs:

Use of proceeds/KPI	SDGs
Green buildings	
	13. Climate action

*The eligible project categories link to these SDGs in the ICMA mapping.

Related Research

- [Analytical Approach: Second Party Opinions: Use of Proceeds](#), July 27, 2023
- [FAQ: Applying Our Integrated Analytical Approach for Use-of-Proceeds Second Party Opinions](#), July 27, 2023
- [Analytical Approach: Shades of Green Assessments](#), July 27, 2023
- [S&P Global Ratings ESG Materiality Maps](#), July 20, 2022

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Second Party Opinion: Verd Boligkreditt's Green Bond Framework

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