Aareal Green Finance Framework - Lending

Aareal
YOUR COMPETITIVE ADVANTAGE.

Aareal Green Finance Framework - Lending

1) Objective and rationale

By disclosing eligibility criteria for environmentally sustainable properties and defining when energy-efficient renovation measures make a significant contribution to the transformation of the existing building stock towards greater energy efficiency, we provide transparency and allow our clients to make informed investment decisions. In addition, this enables us, as a provider of financing solutions in the property sector, to identify and provide green lending and to report it as such.

The building sector is responsible for 30 to 40 percent of the world's total energy requirements and almost 40 percent of its CO2 emissions[1]. This illustrates the extent to which the property sector can contribute to the development of a sustainable economy. We consider financing existing properties (including refurbishments) – i.e. the segment in which we are active – to be a significant lever in this context. By improving transparency and hence identifying potential for emissions reduction, we want to contribute to the transition to a low-carbon economy. Furthermore, we can use covenants (contractually binding assurances by the borrower during the term of the loan, e.g. with regard to energy efficiency upgrades, fixtures and fittings, etc.) to exert a positive influence on the sustainability of the property itself. For us as a mortgage lender, it is of central importance that buildings are and remain attractive and fit for the future, in order to guarantee a steady cash flow on the one hand and refinancing opportunities after the loan commitments expire on the other. Ensuring the sustainable value of the properties we finance is therefore in our own best interests as a company.

With the publication of the European Commission's Action Plan for Financing Sustainable Growth, the importance of sustainability criteria in lending decisions has increased considerably throughout the industry. Among the established and widespread instruments in the area of green finance are green loans. These are defined as loans where the use of funds is linked to specific requirements (e.g. for environmentally friendly, climate-protecting or resource-saving investments) or where the lending terms depend, among other things, on how sustainably the company/borrower behaves (usually measured by established sustainability ratings). Both bilateral and syndicated loans can be arranged so to be green.

We have developed a Green Finance Framework - Lending with the aim of offering our clients green loans to help them achieve their business objectives and hence enhance the property industry's contribution to greater sustainability across society as a whole. The framework will allow us to issue “use-of-proceeds”-based green financing instruments in future, which include, but are not limited to (covered) bonds, loans, commercial paper (‘CP’), repurchase agreements (‘repos’) and deposits.

2) Use of proceeds

Green Lending Programme

We define loans as green when they are used to finance environmentally sustainable/sustainably operated properties (“green buildings” as defined by Aareal). This covers existing building stock and renovated and new buildings, as well as loans provided to finance modernisation/renovation measures (including refurbishments or ADC financing[2]) that (i) upgrade buildings to our defined green building standards or (ii) achieve an improvement in energy efficiency to a defined minimum level (“energy efficiency upgrade” as defined by Aareal).

In preparing this framework, the Bank took into account existing documents and the requirements of the EU Taxonomy, the Association of German Pfandbrief Banks’ minimum standards for green Pfandbriefe, the ICMA Green Bond Principles and the Loan Market Association’s Green Loan Principles.

Building on the premise –in line with our three-continent strategy – of creating a globally applicable framework, Aareal-specific eligibility criteria apply to the classification of properties as “green buildings” or modernisation/refurbishment measures as “energy-related refurbishments” as alternatives to the “EU Taxonomy compliance” criterion.

This makes it possible to assess green lending eligibility even if information is not available on all criteria or if EU Taxonomy compliance has not been sought and verified.

1 According to the International Energy Agency (IEA), almost 40 % of global CO_2 emissions are caused by the building sector.
2 Land acquisition, development and construction (ADC) financing arrangements refer to loans in the course of which plots of land are purchased for the purpose of carrying out development and conversion measures or where construction projects for residential and commercial properties are implemented. [Basel Committee on Banking Supervision, BCBS 424]

Green lending eligibility criteria

All loans used to finance

- green buildings, or
- energy efficiency upgrades

which meet the following eligibility criteria qualify for inclusion in Aareal's Green Lending Programme. Mortgage liens on these green buildings serve as loan collateral.

3) Eligibility criteria

"Green buildings" as defined by Aareal

Aareal Bank defines green buildings as environmentally sustainable properties. This definition is based on our assessment expertise, many years of experience and in-depth property market know-how, as well as on existing green building certificates.

The eligibility criteria may vary depending on the asset class/type of use or the country in question. They are reviewed annually and adapted to changes in statutory environmental requirements and, if necessary, to current market developments.

To qualify as a green building and hence be eligible for green lending, properties must meet at least one of the following three eligibility criteria both at the time of the financing commitment and over the entire financing period:

1. Classification as EU Taxonomy compliant

✓ Buildings meet the EU Taxonomy criteria set out in the EU Commission Delegated Regulation, Chapter 7.7 "Acquisition and ownership of existing buildings".

2. Green building certification (type/level)

✓ Existence of a reputable (i.e. World Green Building Council) green building certificate with an above-average rating, according to the following provider rating categories:

- BREEAM: "Outstanding", "Excellent" and "Very Good"
- LEED: "Platinum" and "Gold"
- DGNB: "Platinum" and "Gold"
- HQE: "Exceptionnel" and "Excellent"
- Green Star: "6 Stars" and "5 Stars"
- NABERS: "6 Stars", "5 Stars" and "4 Stars"

3. Energy efficiency of the property

✓ The property meets the national requirements for a nearly zero-energy building ("nZEB"*) valid at the time of the signing of the loan agreement:

- To reach this standard, the buildings must e.g. be well insulated. In addition, they must use renewable energy sources to cover the remaining energy demand.

* The term "nearly zero-energy building" (nZEB) is defined in the EU Energy Performance of Buildings Directive (EPBD 2010, Directive 2010/31/EU).

and/or

✓ The property falls below the following maximum energy reference values:

- Reference values for total final energy consumption (heating and electricity) for each type of commercial property, which are derived from national requirements/green building requirements and our many years of evaluation practice:

Building type	Final Energy Consumption*
Residential	< 75 kWh/(m² x a)
Office	< 140 kWh/(m² x a)
Retail	< 140 kWh/(m² x a)
Hotel	< 140 kWh/(m² x a)
Logistics	< 65 kWh/(m² x a)

* Until global data availability has improved, final/primary energy demand/consumption can be used as a proxy.

"Energy efficiency upgrade" as defined by Aareal

Improving energy efficiency, particularly in existing buildings, is a key prerequisite for achieving the Paris Agreement's climate targets for the property sector. Against this background, energy-efficient modernisation/renovation measures are highly important.

If a modernisation/renovation measure (including refurbishments or ADC financing) results in the financed building meeting one of the following criteria after completion, it qualifies as an energy efficiency upgrade, and hence the loan that is partially used to finance this renovation qualifies as green lending.

1. **Classification as EU Taxonomy compliant**
   - To qualify, energy-efficient modernisation/renovation measures need to meet the EU Taxonomy criteria according to the EU Commission Delegated Regulation, Chapter 7.1. "Renovation of existing buildings".
2. **Completion of the measure brings the property up to the green building standard defined above.**
3. **Completion of the measure results in an energy efficiency improvement of at least 30%.[1].**

Potential changes to any of the principles governing the content of this framework and new developments with regards to the EU Taxonomy or the EU Green Bond Standard (GBS) will be reflected in future frameworks, with Aareal Bank either retaining or improving the current level of disclosure and standards when selecting eligible assets.

4) Project evaluation and selection

Assessment of green lending eligibility

Eligibility for green lending is assessed at the property level on the basis of selected Aareal-specific eligibility criteria. If the minimum requirements defined by Aareal Bank are met, the property or the modernisation/renovation loan is deemed suitable for green lending and can be financed using a green loan.

The eligibility for green lending of building modernisations/renovations is assessed during the underwriting process and confirmed as a condition precedent prior to the loan being granted. Covenants are included in the loan agreement to ensure ongoing eligibility during the loan term.

1 Based on Regulation (EU) 2020/852 (Taxonomy Regulation) of 18 June 2020

Using a set of eligibility criteria allows an assessment to be made even in cases where not all information for all the criteria is available, while at the same time allowing the requirements to be adapted over time so as to take account of new developments.

A client's interest in a green loan is discussed during the initial sales process by the individual loan originator. The actual assessment of the loan's eligibility for green lending takes place as part of the usual credit process.

Selection Process

Valuation & Research (VAR) incorporates the Aareal Green Lending Programme’s eligibility criteria when assessing the value of properties to be financed. Properties or energy-saving renovations that qualify for inclusion in the Green Lending Programme can be financed using green loans.

Additionally, Credit Transaction Management (CTM) assesses and documents the eligibility of assets and/or activities on the basis of the documentation submitted as part of Aareal’s review of conditions precedent for disbursement.

Furthermore, CTM regularly monitors compliance with green lending covenants where necessary, e.g. where this depends on the existence of valid certificates.

The Green Finance Committee (GFC) may consist of credit, valuation, portfolio management, treasury, legal and sustainability experts and makes any necessary decisions unanimously. The GFC provides guidance on the sustainability criteria for financing transactions and reviews the Green Finance Framework and the on a regular basis. The objective is to ensure that the Framework is up-to-date, appropriate, market-relevant, capable of being applied and of a suitable standard, and to determine possible future amendments should this become necessary.

5) Management of Proceeds

There is always a clearly traceable link between the funds provided by Aareal Bank to a borrower as part of a green loan and their use. The purposes of the loans are usually the direct acquisition, refinancing or renovation of a property or portfolio of properties that meet the criteria in the Green Finance Framework. Aareal Bank finances ringfenced SPV structures; in cases eligible for green lending the loans provided to these SPVs are fully secured by buildings which meet the sustainability criteria laid out in the Green Finance Framework.

The loans provided under the Green Finance Framework are entered in the system. After CTM has confirmed that properties or energy-saving measures meet the Aareal Green Lending Programme eligibility criteria, they are flagged in the system as being “Green Loans”, where appropriate. The relevant documentation (green building certificates, energy certificates, etc.) is stored in the electronic loan files. The green loans are not added to a separate portfolio but are simply flagged as such in the Bank’s loans system; this means that it is possible at any time to report the volume of green loans.

If a document used to assess the eligibility of a property expires, the Bank will request a new, valid document from the client; this must be provided within 10–15 business days.

6) Reporting

The Bank will report annually on changes in the volume of its green loans as part of its non-financial reporting. In addition, the Bank intends to report on relevant impact indicators using selected ICMA-KPIs that could possibly entail progress in building certifications or reductions in energy demand, subject to the availability of suitable information and data. Examples are reg. certification standard (type of certification scheme, certification level and m2 gross building area/gross floor area) and carbon reductions in retrofitted buildings (kg CO_2/m² of gross building area/gross floor area p.a.). Information on intrayear changes (quarterly reporting of the proportion of new business attributable to green lending) will be made available on Aareal's website.

In addition, we will publish a Green Financing Report for as long as any green financing instruments are outstanding. The report will be made available on our investor relations website (link) on at least an annual basis. It is split into two parts: (i) allocation reporting and (ii) impact reporting, and will be made on a best-efforts basis subject to feasibility and data availability.

7) External review

The framework was subjected to a second party review by Sustainalytics before publication; the results have been published in an appendix to the Aareal Green Finance Framework - Lending. Where material changes are made to the subject matter of Framework in the course of the annual framework reviews, Sustainalytics or another entity selected by Aareal will be engaged to review the updated framework.