CASE STUDY: Energy efficiency tagging from a retail & residential mortgage perspective

March 2021

CAJA RURAL DE NAVARRA

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Company Profile

- Caja Rural de Navarra (CRN) is a **cooperative, retail and regional** financial institution operating in the Spanish regions of Navarra, Basque Country and Rioja.

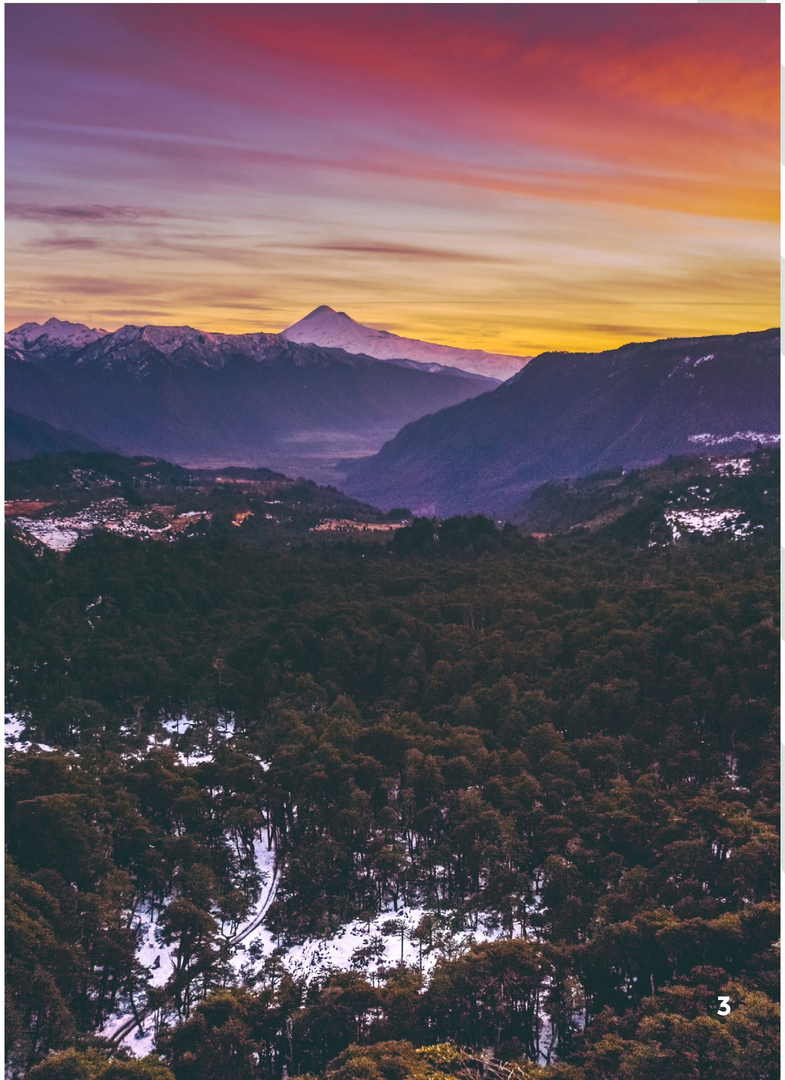
- Around 50% of its lending portfolio is comprised of mortgages, of which:

  75% are for residential

  25% are for commercial

- Caja Rural de Navarra is a regular issuer under a Covered Bond ("Cédulas hipotecarias") programme since 2013, when the inaugural Covered Bond was printed.

- CRN's last two Covered Bonds and its last Senior unsecured issue have been included within its Sustainable bond framework and the Second Party Opinion by Sustainalytics.



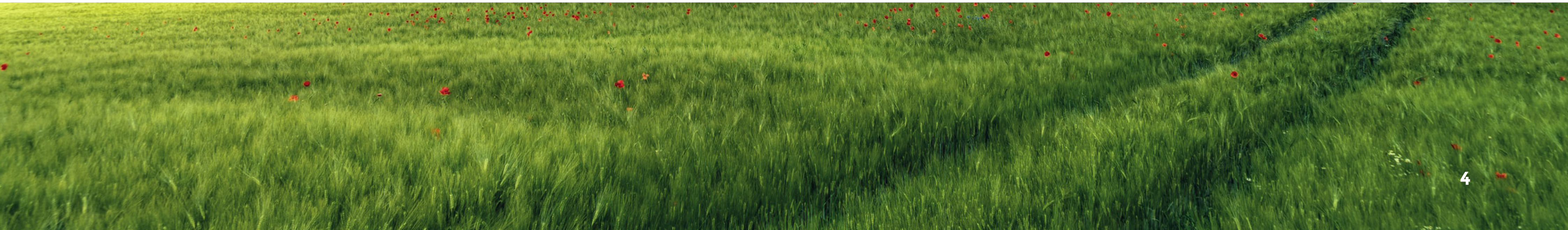
CRN Sustainability framework[1]

- Since 2016, CRN is a sustainable issuer (Covered Bond and Senior Unsecured) under a **Sustainability Bond Framework** (including both social and environmental lines)

- The framework is fully compliant with ICMA's Sustainability Bond Guidelines and the **Green Bond Principles** and **Social Bond Principles**. CRN's 9 sustainability lines are mapped into the **United Nations Sustainable Development Goals** (SDGs)

- Sustainalytics provides a **Second party opinion**

[1] Additional information about the issuer is available at CRN webpage



CRN Sustainability framework[1]

• A **Sustainability impact audited report** is published on an annual basis with comprehensive information on the social and environmental impact of our lending activity.

• Moreover, CRN is making public on a yearly basis a comprehensive **CSR Report** under GRI standards.

• CRN has an active participation in international initiatives within the "Sustainable Finance" development:

EeMAP-EEMI initiative by EMF-ECBC: **https://eemap.energyefficientmortgages.eu/**

ICMA's Green and Social Bond Principles:
https://www.icmagroup.org/green-social-and-sustainability-bonds/membership/

EEFIG: **http://www.eefig.com/**

• We believe that the engagement in these initiatives is positive in order to make a contribution from the retail financial sector to a greener and more sustainable economy and also increase the awareness and alignment of the bank to the EU sustainable and energy efficiency agenda.

[1] Additional information about the issuer is available at CRN webpage

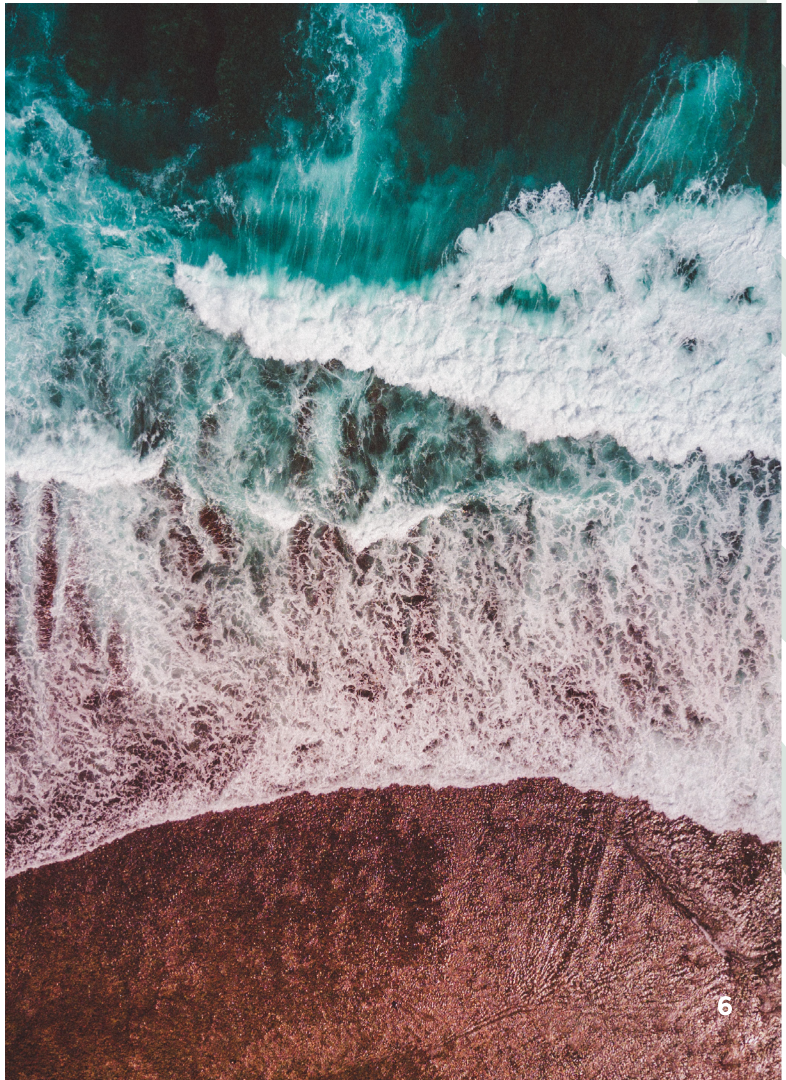
Environmental impact:
Why Buildings Energy Efficiency

- Probably the greatest positive environmental impact that we can favour as a retail and cooperative bank is represented by the physical collateral which underlies our mortgage origination business.

- Due to the fact that most of this collateral is of residential nature, CRN believes that the commitment of retail banks in order to identify, tag and promote greener residential mortgages is key in order to reduce CO_2 emissions in Europe.

- In the EU, buildings are responsible for 40% of the energy consumption & 36% of the CO_2 emissions.

- 75-90% of the building stock in the EU is predicted to still be standing in 2050 making Energy Efficiency (EE) refurbishment and energy efficient mortgage financing a top priority for Europe.



Environmental impact:
Why Buildings Energy Efficiency

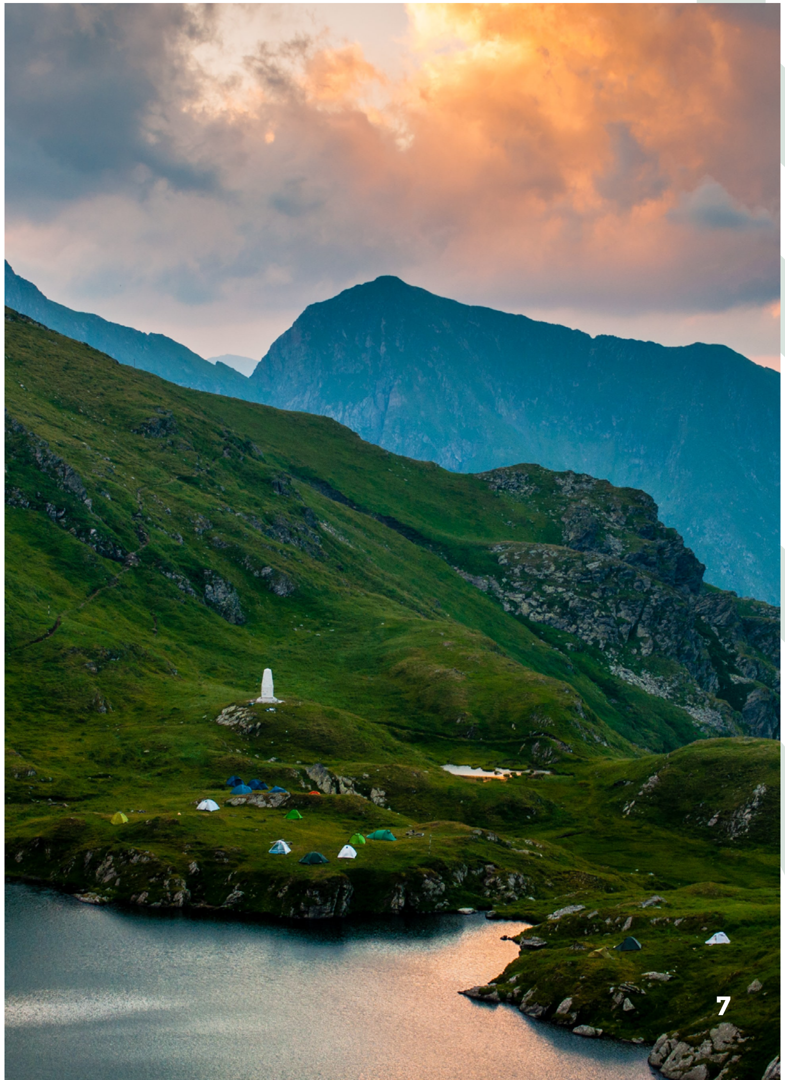
- By improving the EE of buildings, total EU energy consumption could be reduced by 5%-6% CO2 emissions by 5%.

- The EU has set very ambitious energy savings targets for 2020 and 2030 with the scale of the investment needed to meet these targets being estimated at around €100 billion per year.

- It is considered necessary beyond that to invest €100 billion per year until 2050 in the EU building stock in order to deliver on Europe's commitments on climate change.

- While the EU has increased the amount of public funds available for EE, the European Commission suggests there is a need to boost private EE investment to deliver on the 2020 and 2030 energy targets and policy objectives.

- The new EU **Next Generation Fund** shall underpin the focus on EE investments



Tagging Buildings Energy Efficiency:

CRN's approach

- Since 2017 CRN has included in its Sustainable Bond Framework Energy efficient buildings within its eligible use of proceeds. The framework is aligned with the EU Taxonomy[1] for buildings.

- This was a relevant step for us, allowing for a sizeable part of our loan book (residential mortgages) to show its contribution to green finance and, above all, a way to improve our lending criteria by including Energy Efficiency features. This inclusion in our Framework marked the beginning of a challenge: that of tagging our mortgage book accordingly (both existent and newly originated), which involves an important change in IT and lending procedures.

- CRN is green mortgage financing is compliant with the Energy Efficient Mortgage Label.

- Taking into consideration European and Spanish Energy Efficiency regulation (which considers different climate regions and EPCs categories), CRN uses Energy Performance Certificates (EPCs) as established in applicable legislation (Directive 2010/31/UE and Spanish Royal Decree 235/2013 which set up the requirement for EPCs from 1st June 2013 on), in order to evaluate the degree of energy efficiency.

[1] https://www.climatebonds.net/standard/buildings/residential
[2] https://ec.europa.eu/knowledge4policy/publication/sustainable-finance-teg-final-report-eu-taxonomy_en

Tagging Buildings Energy Efficiency

CRN's criteria

CRN's Sustainability framework defines as Energy Efficient (consistently with CBI[1] and EU Taxonomy criteria[2]) loans financing:

- The construction or acquisition of residential units (buildings/ apartments/houses) that represent the top performing in terms of energy efficiency. CRN has decided to include only those units within the "A" and "B" categories, which are well below the 15% best performing threshold of the total stock.

- The retrofitting of residential units that after renovation have achieved at least a 30% improvement in energy performance. CRN will also include those loans granted to owners-associations of residential blocks ("Comunidades de propietarios") to implement new complementary insulation and/or change in centralized heating that achieve at least a 30% improvement in energy efficiency for the whole building.

[1] https://www.climatebonds.net/standard/buildings/residential
[2] https://ec.europa.eu/knowledge4policy/publication/sustainable-finance-teg-final-report-eu-taxonomy_en

Tagging Buildings Energy Efficiency:
3 steps Work method

1. **Mortgages of individual properties where CRN financed the real estate development, as it therefore already has the relevant data of that building;**

This allows the bank to know the EPC of those individual homes within that building.

2. **Existing individual mortgages not included in the above-mentioned group;**

This work flow requires innovative IT tools to be deployed as existing databases on EPCs:

- Are not publicly available on a database format with a link to the property registry identification ID.
- Cannot be easily matched to the mortgage book of the bank as they rely on alphanumeric fields (postal address) previously included manually into IT platforms and that is why CRN is exploring advanced algorithms able to find reliable solutions.

3. **…and new origination;**

- CRN requires all new mortgages from June 2019 on, to include EPCs data. We have already created 4 new fields: letter and figure for both 'consumption' (kWh/m2) and 'emissions' (CO^2/m^2)
- We are closely working with appraisers to include EPCs automatically as an independent IT field and not just part of a PDF document.

Tagging Buildings Energy Efficiency:

Updated results

	Amount (millions of €)	Number of loans
EPC A	260.2	1,944
EPC B	145.6	1,265
Renovations	9.8	69

TOTAL

- Amount **€ 415.6 million**
- Number of loans **3,278**
- Estimated CO_2 emissions annual reduction[1] **17,672 Tn.**

- Almost all green tagged mortgages are residential.
- This already represents around 11% of our residential mortgage book
- However, a significant number of Energy Efficient mortgages remain untagged due to lack of information availability

[1] Assuming newbuild appartments (within a building block), with 90m2 average floorspace and average emissions of 69.80 kg CO2eq/m2 annually and compared with the Spanish average of the building stock.

Annex:
Challenges ahead

- **Granularity of retail exposures**

The granularity of smaller loans in general, and residential mortgages in particular (compared to project finance or commercial mortgages) pose a difficult challenge, for which retail banks are best positioned to provide ideas to overcome such hurdles due to their direct and close knowledge of their client base and their loan book detailed composition.

- **Data collection**

This was a relevant step for us, allowing for a sizeable part of our loan book (residential mortgages) to show its contribution to green finance and, above all, a way to improve our lending criteria by including Energy Efficiency features. This inclusion in our Framework marked the beginning of a challenge: that of tagging our mortgage book accordingly (both existent and newly originated), which involves an important change in IT and lending procedures.

- **Harmonisation and common taxonomy**

Existing market practices[1] already offer an standardised approach: CRN's has designed its Energy efficient buildings' financing framework with a view on market practices and data reliability. The Second Party Opinion by Sustainalytics concludes that *"Sustainalytics positively notes the targeting of the top 15% of building stock for acquisitions and the establishment of a minimum energy efficiency threshold for renovations and retrofitting."*

Moreover, Sustainalytics states that *"Sustainalytics views CRN loans to refurbishments as contributing to the improvement of the energy performance of the existing residential building stock."*

[1] https://www.climatebonds.net/standard/buildings/residential
[2] https://ec.europa.eu/knowledge4policy/publication/sustainable-finance-teg-final-report-eu-taxonomy_en

Annex:

Why remain committed

- **The Investor's perspective:**

In our view, investors benefit from accessing financial instruments with a 'use of proceeds' commitment which is aligned with their investment policy. In this sense, transparency, harmonization and allocation & impact reporting are key elements to leverage sustainable finance from the investor's perspective. The recent EU High Level Expert Group's final report and the expected European legislative initiative to impulse sustainable finance will also be in CRN's point of view a clear game-changer.

Moreover, there is in many investors' view a clear link between a Sustainable bonds' framework and the overall ESG strategy of the bank. That is why many investors believe that banks who are first-movers as sustainable bond issuers have a more resilient Governance structure and a long-term strategic perspective which, in turn, can lead to better management, healthier credit metrics and therefore to a lower volatility and better performance of their bonds

- **The lender / issuer's perspective:**

We are convinced that its Sustainable issues have benefited from a broader investor base. Taking as example its last Sustainable Covered Bond issued in April 2018, it achieved the highest oversubscription ratio (more than 3x) of any euro benchmark covered bond until that time of the year and got a highly granular and diversified investor base, with one of the highest allocation to Green and Sustainable investors (65%).

This is a clear proof of the importance that ESG factors are gaining in the success of bond transactions, both from the point of view of investors (with a clear focus on asset managers, pension funds, central banks and sovereign funds) and issuers.

Moreover, adopting EE criteria helps the bank to focus on EE loan origination, improving borrowers' resilience and collateral values, as well as positioning itself in a growing market.

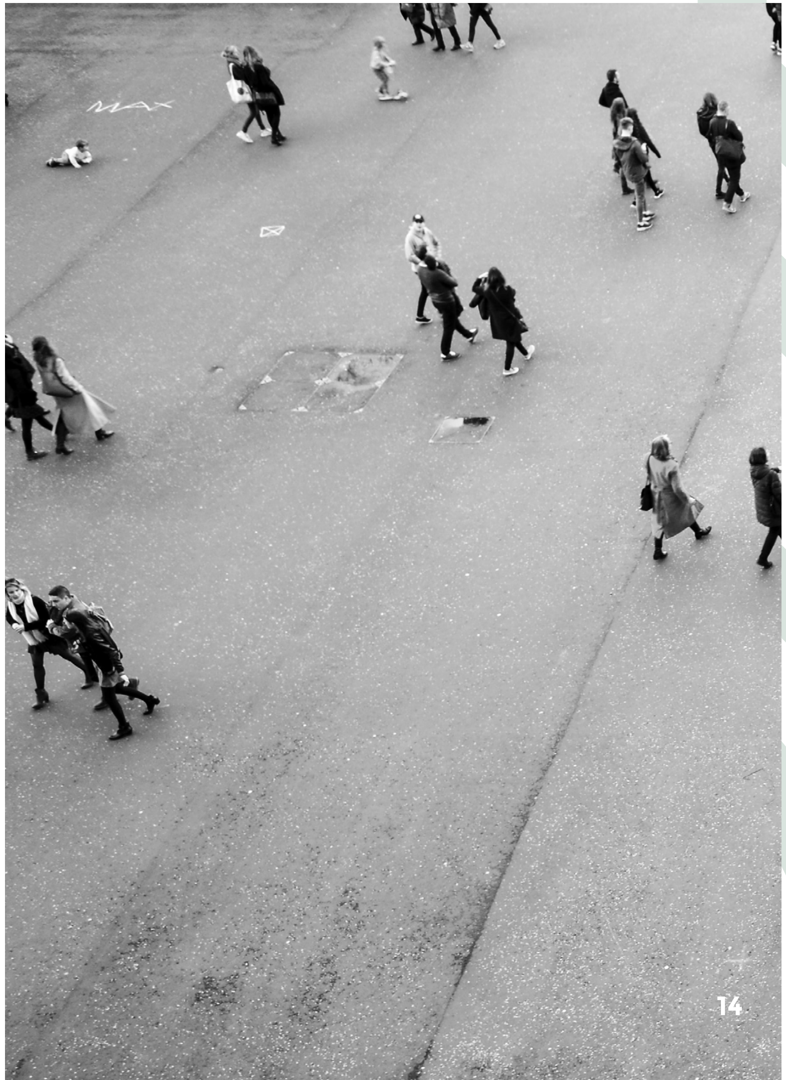
Annex:
Why remain committed

· **The financial sector / public authorities / society's perspective:** CRN is attached to its home regions and believes that its ESG strategy is an essential element of its proximity banking model.

From a broader perspective, banks play a key role in the European financial sector. Even in the context of the Capital Markets Union (CMU) project, European banks will retain a great relevance as key players in changing the economy towards a more sustainable environment and a more inclusive society.

Within this background, retail banks are uniquely placed to originate eligible (from a sustainability perspective) assets. These assets could be bonds and/or loans, and different ways to channel financing to them could be envisaged. However, all of these ways will have in common the need for a common taxonomy, a regulatory level-playing field and the right incentives to help this change happen.

That is why CRN believes that the involvement of smaller banks with a local and retail focus is key in order to reach all regions, citizens and SMEs of the EU. If a reasonable, not too burdensome legal framework is put in place and proportionality is taken into account, smaller, and particularly cooperative banks are best placed to channel finance to the real economy with a focus on sustainable social and environmental projects in which Energy efficient buildings will play a key role.



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