Aareal Green Finance Framework - Lending

May 2023

Aareal

YOUR COMPETITIVE ADVANTAGE.

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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. 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 reduction of greenhouse gas emissions. We consider financing existing properties (including energy efficiency upgrades) 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. For us as a mortgage lender, it is of central importance that buildings are and remain attractive and fit for the future. Ensuring the sustainable value of the properties we finance is therefore in our own best interests.

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).

We have developed the Green Finance Framework Lending with the aim of offering our clients green loans to help them achieve their business objectives and hence enhance the real estate industry's contribution to greater sustainability across society as a whole. This framework allows us to issue green financing instruments, in the form of Green Loans.

2) Use of Funds for Green Loans

Green Lending Programme

We define loans as green when they are used to finance environmentally sustainable buildings - “green properties” as defined by Aareal. This covers existing building stock, 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 property standards or (ii) achieve an improvement in energy efficiency to a defined minimum level (“energy efficiency upgrade” as defined by Aareal).

All Green Loans are used to finance

- green properties, or
- energy efficiency upgrades

which meet the eligibility criteria laid out in paragraph 3 to qualify for inclusion in Aareal’s Green Lending Programme. Mortgage liens on these green buildings serve as loan collateral.

In preparing this framework, the Bank took into account 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[3].

Aareal-specific eligibility criteria are applied to the classification of buildings as “green properties” or modernisation/refurbishment measures as energy efficiency upgrades, thereby providing alternatives to the “EU Taxonomy compliance” criterion and creating a globally applicable framework.

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]
3 Green Loan Principles - LSTA as per February 2023

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.

3) Eligibility criteria

"Green Properties" as defined by Aareal

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 property and hence be eligible for green lending, properties must meet at least one of the following four eligibility criteria both at the time of the financing commitment and over the entire financing period:

a) 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".

b) 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 "4,5 Stars"
  - Energy Star: Score of at least 80

c) Energy efficiency of the property

- ✓ 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)**

* final energy consumption is considered after offsetting measures such as on-site generation of electricity through renewable sources i.e., photovoltaic systems or district heating networks. Until global data availability has improved, final/primary energy demand/consumption can be used as a proxy. Generally we ask for proof of final energy consumption through a third party i.e. EPCs or utilities providers.

and/or

- ✓ 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).

d) “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:

i. 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 7.2. “Renovation of existing buildings”.

ii. Completion of the measure brings the property up to the green building standard defined above.

iii. Completion of the measure results in an energy efficiency improvement of at least 30%[1] or - preferably - reduces energy consumption of a building below the maximum thresholds defined above

4) Project evaluation and selection

Assessment of green lending eligibility

Eligibility for green lending is assessed at the property level on the basis of the above 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. Individual Green Buildings, that are part of portfolio transactions in which several properties are financed, can also be utilised for Green Loans. In these cases portions of the overall loan which are allocated to the individual Green Buildings can be classified as Green Loan. Loan portions are allocated to individual properties of the portfolio weighted according to market values. Assessments can be conducted on a preliminary basis by originators to give clients an indication on eligibility. Specific requirements with regards to the validity and recency of certificates apply. As a standard Aareal screens for environmental risks (both transitory and physical) as part of the credit process. Social and governmental risks too are monitored and managed as part of the banks Non-Financial-Risk management.For this purpose Aareal Bank uses dedicated E,S & G-Scores on the property level. This is also true for loans to be classified as Green Loans.

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 / the loan being renewed. Covenants are included in the loan agreement to ensure ongoing eligibility during the loan term.

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.

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

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

Eligibility is assessed and documented by loan origination and credit management functions involved in the credit process on the basis of the documentation (i.e. Energy Performance Certificates, Green Building Certificates etc.) submitted as part of Aareal's review of conditions precedent for disbursements / renewals. Final determination of eligibility is conducted by Credit-Management (CM) which performs the ultimate check that all requirements prior to funding are fulfilled.

Furthermore, compliance with green lending covenants, which form part of the detailed loan documentation, is regularly monitored, e.g. where this depends on the existence of valid certificates.

The ESG-Expert-Group (EEG) provides guidance on the sustainability criteria for financing transactions and reviews the Green Finance Framework on a regular basis to determine possible future amendments should these become necessary. The objective is to ensure that the Framework is up-to-date, appropriate, market-relevant, actionable and of a suitable standard. The Green Finance Committee (GFC), whose core function is the management of the green asset pool, may also request a review of the Green Finance Framework and the underlying sustainability criteria conducted by the EEG when the GFC deems this necessary. Both the EEG and the GFC may consist of credit, valuation, portfolio management, treasury, legal and sustainability experts.

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.

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 structured as Green Loans the funds provided to these SPVs are secured by buildings which meet the sustainability criteria laid out in this framework.

After eligibility of the properties or energy-saving measures is confirmed by both first and second line functions, 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 twelve months.

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.