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‘Second Opinion’ on Kommunalbanken Norway (KBN)’s Green Bond Framework

Contents

Summary	2
1. Introduction and Background	2
Expressing concerns with ‘shades of green’	3
2. Brief Description of KBN’s Bond Framework and Rules and Procedures for Climate-Related Activities.....	3
3. Assessment of KBN’s Green Bond Framework and environmental policies	5
Eligible projects under the Green Bond Framework.....	5
Strengths.....	7
Weaknesses	7
Pitfalls	7
Transparency, monitoring, reporting and verification	7
References	8
About CICERO.....	8

Summary

Kommunalbanken Norway (KBN) finances important welfare services through providing credit to the local authorities in Norway. KBN is defined as a state instrumentality, having a public policy mandate from the central government to provide low cost financing to the Norwegian local government sector. KBN's lending to the local government sector is funded by issuing securities in the international capital markets maintaining the highest possible credit rating. KBN is a wholly owned state company. KBN has a lending product specifically designed to finance investment in climate-friendly projects by the local government sector. The interest rate on this 'green loan' product is lower than KBN's ordinary floating rate.

Overall, the KBN'S Green Bond Framework provides a specific, detailed and sound framework for climate-friendly investments. The Green Bond Framework lists eligible projects that are supportive of the objective of promoting a transition to low-carbon and climate-resilient growth and is supported by a reasonably strong governance structure. In common with many issuers, the standards for refurbishment of old buildings are going beyond required building standards today, but are not requiring best available practices (e.g. passive housing) in this sector.

CICERO is encouraged to see that KBN includes in their annual newsletter impact reporting where relevant. Impact reporting is an important tool to enhance transparency in regard to the projects economic risk from climate change and the environmental effectiveness of the projects. KBN's Green Bonds can be used to finance new projects but also refinance projects.

Based on an overall assessment of the activities that will be financed by the green bonds, KBN's Green Bond Framework gets the Dark Green shading.

1. Introduction and Background

As an independent, not-for-profit, research institute, CICERO (Center for International Climate and Environmental Research - Oslo) provides Second Opinions on institutions' framework and guidance for assessing and selecting eligible projects for green bond investments, and assesses the framework's robustness in meeting the institutions' environmental objectives. The Second Opinion is based on documentation of rules and frameworks provided by the institutions themselves (the client) and information gathered during meetings, teleconferences and e-mail correspondence with the client. CICERO encourages the client to make this Second Opinion publically available. If any part of the Second Opinion is quoted, the full report must be made available.

CICERO has established the global Expert Network on Second Opinions (ENSO), a network of independent non-profit research institutions on climate change and other environmental issues, to broaden the technical expertise and regional experience for Second Opinions. CICERO works confidentially with other members in the network to enhance the links to climate and environmental science, building upon the CICERO model for Second Opinions. In addition to CICERO, ENSO members currently include Basque Center for Climate Change (BC3), International Institute for Sustainable Development (IISD), Stockholm Environment Institute (SEI), and Tsinghua University's Institute of Energy, Environment and Economy. A more detailed description of CICERO can be found at the end of this report.

CICERO's Second Opinions are normally restricted to an evaluation of the mechanisms or framework for selecting eligible projects at a general level. CICERO do not validate or certify the climate effects of single projects, and thus, has no conflict of interest in regard to single projects. CICERO is neither responsible for

how the framework or mechanisms are implemented and followed up by the institutions, nor the outcome of investments in eligible projects.

Proceeds from green bonds may be used for financing, including refinancing, new or existing green projects as defined under the mechanisms or framework. CICERO assesses in this Second Opinion the likeliness that the issuer's categories of projects will meet expectations for a low carbon and climate resilient future.

Expressing concerns with 'shades of green'

CICERO takes a long-term view on activities that support a low-carbon climate resilient society. In some cases, activities or technologies that reduce near-term emissions result in net emissions or prolonged use of high-emitting infrastructure in the long-run. CICERO strives to avoid locking-in of emissions through careful infrastructure investments, and moving towards low- or zero-emitting infrastructure in the long run.

CICERO Second Opinions are graded dark green, medium green or light green, reflecting the climate and environmental ambitions of the bonds and the robustness of the governance structure of the Green Bond Framework.

This Second Opinion will allocate a 'shade of green' to the Green Bond Framework of KBN:

- Dark green for projects and solutions that are realizations today of the long-term vision of a low carbon and climate resilient future. Typically, this will entail zero emission solutions and governance structures that integrate environmental concerns into all activities.
- Medium green for projects and solutions that represent steps towards the long-term vision, but are not quite there yet.
- Light green for projects and solutions that are environmentally friendly but do not by themselves represent or is part of the long-term vision (e.g. energy efficiency in fossil based processes).
- Brown for projects that are irrelevant or in opposition to the long-term vision of a low carbon and climate resilient future.

The project types that will be financed by the green bond primarily define the overall grading. However, governance and transparency considerations also factor in, as they can give an indication whether the institution that issues the green bond will be able to fulfil the climate and environmental ambitions of the investment framework.

2. Brief Description of KBN's Bond Framework and Rules and Procedures for Climate-Related Activities

Kommunalbanken Norway (KBN) finances important welfare services through providing credit to the local authorities in Norway. KBN is defined as a state instrumentality, having a public policy mandate from the central government to provide low cost financing to the Norwegian local government sector. KBN's lending to the local government sector is funded by issuing securities in the international capital markets maintaining the highest possible credit rating. KBN is a wholly owned state company.

KBN became a member of Transparency International in 2014. KBN has a lending product specifically designed to finance investment in climate-friendly projects by the local government sector. The interest rate on this 'green loan' product is lower than KBN's ordinary floating rate. The proportion of KBN's lending portfolio represented by lending at this green rate increased from 3.6% in 2013 to 4.3% in 2014. KBN prepares

an annual environmental report which details its performance in relation to a range of established criteria. KBN is Eco-Lighthouse certified, and is also a control member of the Green Dot (Grønn Punkt) recycling scheme. KBN applies environmental criteria to its suppliers of goods and services, and actively prefers suppliers that have environmental certification.

KBN's Green Bond eligible projects promote the transition to a low-carbon and climate resilient Public Sector and include both mitigation and adaptation projects. Such projects may target (a) mitigation of climate change through reduction of emissions from buildings, transportation and energy production, (b) adaptation to climate change, including investments in climate-resilient infrastructure, or (c) to a smaller extent (limited to 10%), projects related to a sustainable environment on a local scale.

For a project to be included in the Eligible Projects pool, it shall comply with a) the categories listed in Table 2 below and in the "KBN Green Bonds: Supplementary guidelines for project selection, documentation and reporting" (document 2 in Table 1), b) the Municipality's Environmental Plan, and c) Norway's Intended Nationally Determined Contributions (INDCs) according to the Paris Agreement (document 8 in Table 1). Applicants are required to declare eligibility by filling in a designated section in the loan document. Additionally, relevant documents indicating the Project's estimated environmental performance shall be provided. A project's eligibility is assessed by the Lending Department and approved by the the Climate Controller. Approved Green Projects are entitled to KBN's Green Lending Discount and included in the bank's portfolio of Green Projects.

To enable investors to follow the development and provide insight into prioritized areas, KBN will provide an annual Social Responsibility Indicator (SRI) report linked to the annual financial results report. The SRI report will include a section on the progress of the Green Bond program. KBN will also keep the dedicated Green Bond webpages continuously updated with; 1) a list of projects financed; 2) a selection of project examples "Green Bond Stories" and; 3) a summary of the KBN Green Bond development including statistics on our Green Project portfolio with impact reporting, aiming to comply with the issuer group's "Harmonized Framework for Impact Reporting" (EIB 2015).

KBN has appointed an advisory board, "The Green Committee", whose mandate will be to provide advice and guidance in matters related to the Bank's Green Bond Framework. The committee will primarily draw on external expertise in related fields, but will also include members of the KBN staff. KBN's Green Bond process will be audited by KBNs internal auditor, currently KPMG.

KBN's Green Bonds can be used to finance new projects but also refinance existing projects. The ambition is however to use the majority of the Green Bond proceeds to finance new projects.

The table 1 below lists the documents that formed the basis for this Second Opinion.

Table 1: Documents Received from the client

Document Number	Document Name	Description
1	KBN's Green Bond Framework	A document describing the use of proceeds, evaluation and selection process, the management of proceeds and reporting. Updated June 2016.

2	KBN Green Bonds: Supplementary guidelines for project selection, documentation and reporting.	A very useful document describing in detail categories and criteria, reporting procedures and methodologies employed. Updated 25 May 2016.
3	KBN Green Projects.	A listing of the green lending portfolio 2013-2015. http://www.kommunalbanken.no/en/funding/funding-program/green-bonds/green-projects
4	KBN Annual Report	Annual report from 2014. http://www.kommunalbanken.no/media/149636/2014-annual-report-en.pdf
5	KBN Corporate Social Responsibility	A web page with links to code of conduct, CSR reports, description of visions and values, etc. http://www.kommunalbanken.no/en/corporate-social-responsibility
6	White paper on Norwegian climate policy (pp 138-143)	A chapter on climate change and the municipalities. https://www.regjeringen.no/no/dokumenter/Stmeld-nr-34-2006-2007-/id473411/
7	Kommunenes arbeid med klima og energi	A web page with links to some relevant pages for municipalities when it comes to plan and seek support for climate and energy initiatives. http://www.klimakommune.enova.no/sitepageview.aspx?sitepageid=1416
8	Norway's Intended Nationally Determined Contributions.	Submission by Norway to the UNFCCC/ADP on Norway's Intended Nationally Determined Contribution. http://www4.unfccc.int/submissions/INDC/Published/Documents/Norway/1/Norway INDC 26MAR2015.pdf

3. Assessment of KBN's Green Bond Framework and environmental policies

Overall, the KBN's Green Bond Framework provides a detailed and sound framework for climate-friendly investments. The framework and procedures for KBN's green bond investments are assessed and their strengths and weaknesses are discussed in this section. The strengths of an investment framework with respect to environmental impact are areas where it clearly supports low-carbon projects, whereas the weaknesses are typically areas that are unclear or too general. Pitfalls are also raised in this section to note areas where issuers should be aware of potential macro-level impacts of investment projects.

Eligible projects under the Green Bond Framework

At the basic level, the selection of eligible project categories is the primary mechanism to ensure that projects deliver environmental benefits. Through selection of project categories with clear environmental benefits, green bonds aim to provide certainty to investors that their investments deliver environmental returns as well as financial returns. The Green Bonds Principles (GBP, see ICMA 2015) state that the "overall environmental profile" of a project should be assessed and that the selection process should be "well defined".

KBN defines eligible project categories and examples of eligible projects as shown in Table 2. We show our rating (shading) and note some concerns in the last column of the table. Occasionally KBN may deem eligible

projects falling outside the categories listed in Table 2. These projects will be scrutinized individually and must be followed by clear documentation of very positive environmental and climate impacts and otherwise follow the requirements described under the framework.

Table 2 Eligible project categories

Category	Examples of eligible project types	Green Shading and some concerns
Renewable energy	Examples: <ul style="list-style-type: none"> • Solar • Wind • Waves • Fossil free district heating • Geothermal 	Dark Green <ul style="list-style-type: none"> ✓ Avoid plastic waste in district heating ✓ Beware of heavy metal pollution sometimes associated with geothermal energy ✓ Beware of environmental issues in association with wind farms.
Energy efficiency existing buildings	<ul style="list-style-type: none"> • At least 25% reduction in estimated energy use or documented support from ENOVA. 	Medium Green <ul style="list-style-type: none"> ✓ In order to reach dark green, energy efficiency improvements will have to be considerably higher.
Energy efficiency new buildings	<ul style="list-style-type: none"> • New buildings: BREEAM Excellent or Outstanding. At least 20% lower energy use than existing standards. Documented support from ENOVA. 	Dark Green <ul style="list-style-type: none"> ✓ New houses, as long standing infrastructure, requires the highest standards to receive Dark green, typically BREEAM Outstanding or passive houses or net positive energy houses.
Waste management	Examples: <ul style="list-style-type: none"> • Biogas from waste • Remediation of old waste sites • Non-fossil based waste collection • Carbon capture 	Dark Green <ul style="list-style-type: none"> ✓ Should comply with existing and relevant EU directives.
Land use	Sustainable use of land such as: <ul style="list-style-type: none"> • Conversion of areas from e.g. parking places to recreational areas, forestation projects, and reclamation or preparation of areas for walking, biking and public transport. 	Dark Green <ul style="list-style-type: none"> ✓
Low carbon transportation	Non-fossil solutions such as: <ul style="list-style-type: none"> • Non-fossil public transport • Pedestrian and cycle lanes • Cycle 'hotels' • Cars based on renewable energy • Charging stations 	Dark Green <ul style="list-style-type: none"> ✓ Very good that fossil fuel based solutions are to be avoided
Water and wastewater management	<ul style="list-style-type: none"> • Upgrading of water and wastewater pipelines • Energy and heat recovery from waste water • Water treatment 	Dark Green <ul style="list-style-type: none"> ✓

Climate change adaptation	<ul style="list-style-type: none"> • Infrastructure to handle flooding, avalanches, sea level change, etc. 	Dark Green ✓ A clear adaptation profile is required.
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Strengths

KBN as a funder of a variety of projects in Norwegian municipalities faces a challenge when it comes to defining what should be counted as eligible projects for green finance. KBN answer this challenge in a good manner in document no. 2 (see Table 1): “KBN Green Bonds: Supplementary guidelines for project selection, documentation and reporting.” Here, examples, criteria and required documentation is spelled out in details in a manner that mostly convince us that green funding from KBN goes towards securing very good long term solutions required for a climate friendly and resistant society in the future. However, the criteria for energy efficiency projects in existing building do not go all the way towards best possible practices as non-passive housing is included among eligible projects. Our grading of this type of projects therefor is ‘medium green’ – a good grading for projects on the way to a low carbon society, but not quite there yet.

A project's eligibility is assessed by the Lending Department and approved by the the Climate Controller thus securing a “green veto” in the selection of projects – a clear strength of the governance structure.

When it comes to transparency and reporting, KBN has in place a system for impact reporting from larger projects (above NOK 25 million) that secure a positive sharing of good experiences among investors as well as municipal project owners. We see this as a very positive element of the Green Bond Framework.

Weaknesses

We find no weaknesses in KBN’s Green Bond Framework.

Pitfalls

Impacts beyond the project boundary

Due to the complexity of how socio-economic activities impact the climate, a specific project is likely to have interactions with the broader community beyond the project borders. These interactions may or may not be climate-friendly, and thus need to be considered with regards to the net impact of climate-related investments.

Rebound effects

Efficiency improvements may lead to rebound effects. When the cost of an activity is reduced there will be incentives to do more of the same activity. From the project categories in Table 2 an example is improved energy efficiency, which in part may lead to more energy use. KBN should be aware of such effects and possibly avoid Green Bond funding of projects where the risk of rebound effects is particularly high.

Transparency, monitoring, reporting and verification

Transparency, reporting and verification are key in order to enable investors to follow the implementation of the KBN Green Bond Program. Without becoming too burdensome impact reporting enhances transparency concerning the projects economic risk from climate change and the environmental effectiveness of the projects.

KBN has in place good procedures for monitoring and reporting of green bond projects. KBN will provide an annual newsletter to the green bond investors. This investor letter will be made publically available on KBN’s

web page. The processes for allocation of use of proceeds, tracking and management of funds will be part of KBN's annual external audit with the same scope as the Sustainability Report.

Impact reporting is an important tool to enhance transparency in regard to the projects economic risk from climate change and the environmental effectiveness of the projects.

References

EIB (2015): Joint communication on a revised proposal for Green Bond impact reporting harmonization. See: <http://www.eib.org/infocentre/press/releases/all/2015/2015-283-joint-communication-on-a-revised-proposal-for-green-bond-impact-reporting-harmonization.htm?media=rss&language=en>

ICMA (2015) Green Bond Principles. <http://www.icmagroup.org/Regulatory-Policy-and-Market-Practice/green-bonds/green-bond-principles/>

IPCC (2013). *Climate Change 2013: The Physical Science Basis. Contribution of Working Group I to the Fifth Assessment Report of the Intergovernmental Panel on Climate Change* [Stocker, T.F., D. Qin, G.-K. Plattner, M. Tignor, S.K. Allen, J. Boschung, A. Nauels, Y. Xia, V. Bex and P.M. Midgley (eds.)]. Cambridge University Press, Cambridge, United Kingdom and New York, NY, USA, 1535 pp. <http://ipcc.ch/report/ar5/wg1/>

About CICERO

CICERO (Center for International Climate and Environmental Research – Oslo) is Norway's foremost institute for interdisciplinary climate Research. We deliver new insight that help solve the climate challenge and strengthen international climate cooperation.

We help to solve the climate problem and strengthen international climate cooperation by predicting and responding to society's climate challenges through research and dissemination of a high international standard. Our researchers collaborate with top researchers from around the world, and publish their work in recognized international journals, reports, books and periodicals.

CICERO has garnered particular attention for its research on the effects of manmade emissions on the climate, society's response to climate change, and the formulation of international agreements. We have played an active role in the IPCC since 1995. In recent years we have also developed considerable expertise in climate financing and is currently a lead provider of Second Opinions on Green Bonds.

CICERO has a national role in promoting knowledge about climate change and is internationally recognised as a driving force for innovative climate communication. We are in constant dialogue about the responses to climate change with public and private decision makers, government administration and civil society.

See: <http://www.cicero.uio.no/en/posts/news/cicero-grades-climate-friendly-bonds-with-shades-of-green>