

Annual Report 2021

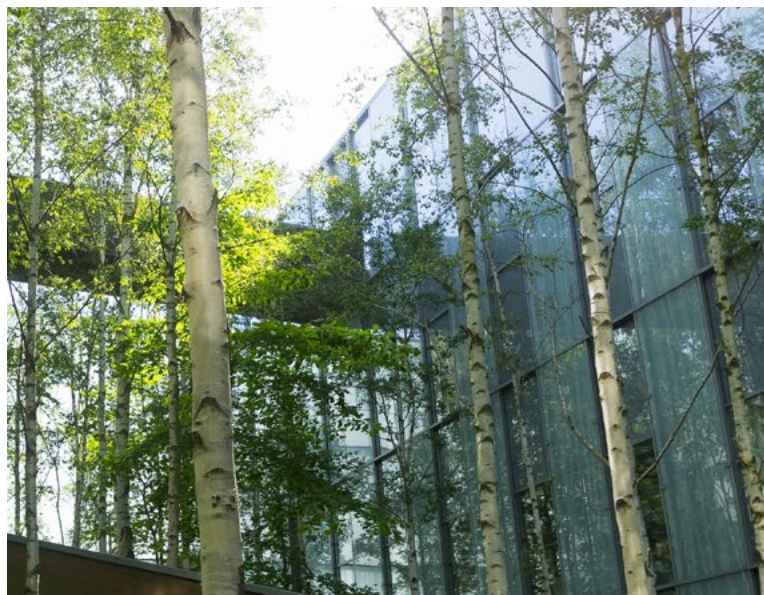
# Capital market: Setting an innovative, bold path for the future

Berlin Hyp consistently continued on its path as a major player on the ESG capital market in 2021 and strengthened both its position as the most active issuer of green bonds among European commercial banks and its reputation as an ESG pioneer. For example, the bank issued three more green bonds in benchmark format in 2021 and had a total of 14 outstanding green bonds in the covered bond, senior preferred and senior non-preferred asset classes at the end of the financial year. The Bank also continued to break new ground by issuing its first sustainability-linked bond (SLB). This was the first time that the Bank had issued such a bond aligned with its own corporate ESG goals.

## What exactly is a Sustainability-Linked Bond?

The SLB has only been available since 2019. The Italian utility Enel emitted a sustainable bond for the first time, breaking with the previous use of proceeds approach and instead serving general corporate financing. What makes the bond sustainable is the fact that the issuer makes the amount of the coupon dependent on whether they manage to achieve their own strategic corporate goal within a defined period. If the issuer fails to do this, the bond coupon will increase by a predetermined number of basis points. Enel's performance on the capital market was so convincing that the International Capital Markets Association published the Sustainability-Linked Bond Principles back in June 2020 to provide investors and potential issuers with guidelines for the new product category.

The Sustainability-Linked Bond Principles refer to five different aspects that should be considered when structuring a bond. First, the issuer is required to determine one or more key performance indicators (KPIs). These KPIs should be anchored in the issuer's strategy and should be sustainably relevant both for the issuer themselves and for their entire economic sector. Secondly, at least one strategic ESG goal – referred to as a Strategic Performance Target (SPT) in the original text – must be calibrated for each of the selected KPIs. The SPT must also be derivable from the corporate strategy, indicate a high level of ambition and have a clear schedule. Thirdly, if the issuer does not achieve this SPT, a pre-determined adjustment is made to specific bond characteristics. For example, increasing the bond coupon could be an option here. Fourthly, issuers should provide information on the SPT's progress on an annual basis.



The issuer sets out how they aim to deal with these four points in an SLB Framework which they make publicly available and which they also have verified by an external independent third party. This step is the fifth principle of the Sustainability-Linked Bond Principles. It is recommended that both the annual reporting and the achievement of the SPT are re-verified. As with green bonds, external assessments are often carried out by sustainability rating agencies.

## The first Sustainability-Linked Bond to be issued by a bank

After the Sustainability-Linked Bond Principles were published, new issues quickly picked up. More and more companies from different industries emerged with KPIs and SPTs tailored to their specific economic sector which addressed their key ESG challenges. The question still remained as to how a bank, given its relatively low CO<sub>2</sub> emissions in comparison with other sectors, can meaningfully design an SLB. But on 9 April 2021, Berlin Hyp provided an answer to this question by publishing its Sustainability-Linked Bond Framework.



## Berlin Hyp Sustainability-Linked Bond



The framework for the first SLB to be issued by a bank builds on Berlin Hyp's sustainability agenda presented in August 2020, which was further developed into a comprehensive ESG vision in 2021. Its overarching element is the Bank's commitment to the central goal of the Paris Agreement, which is to limit global warming to less than 2 degrees Celsius by 2050. The Bank is also committed to Germany's Climate Path for the building sector as defined in the German Federal Climate Change Act, which, until the Act is amended, envisioned a 40 per cent reduction in CO<sub>2</sub> emissions in the building sector between 2020 and 2030.

Berlin Hyp's commitment applies to both its own business operations and its entire loan book. This business strategy objective provided the real estate financier with the key performance indicator for its SLB, namely the rate of reduction in the CO<sub>2</sub> intensity of its loan portfolio compared with the baseline of 2020. It also provided the Bank with the Strategic Performance Target for this SLB, which quantifies this reduction to 40 per cent between 2020 and 2030.

The energy values of the financed properties must be known to the Bank in order to be able to determine both the baseline and the annual reduction rate. For Berlin Hyp's Green Finance portfolio, these values are documented in the Bank's systems and form the basis of the annual Green Bond reporting. At the end of 2020, corresponding data was available for an overall 35 per cent of the nominal volume financed. For the remaining 65 per cent, we determined approximate values together with specialists from the consulting firm Drees & Sommer that were largely based on the type of use of the buildings, their year of construction and their state of renovation. Using the methodology for determining the carbon footprint set out in the Sustainability-Linked Bond Framework, Berlin Hyp's loans portfolio had a carbon intensity of 38.62 kg CO<sub>2</sub>/m<sup>2</sup>/a for the baseline year of 2020.

### Success on the capital market

The concept presented was met with a widespread, very positive response on the capital market. When Berlin Hyp opened the books for its first Sustainability-Linked Bond on 13 April 2021, there was such a keen interest from investors that the ten-year senior preferred bond was finally issued at a reoffer spread of mid-swap + 30 basis points – one of the most favourable refinancing levels to have ever been achieved with a euro-dominated bond in this term time. The Bank’s pioneering achievement has

also been recognised with several awards. Berlin Hyp was internationally recognised as the “Most Impressive Financial Institution Green/SRI Bond Issuer” at the annual GlobalCapital Bond Awards in 2021. The Bank was also awarded “Best ESG Issuer” at the GlobalCapital Covered Bond Awards and also acknowledged by BANKMAGAZIN at its annual Sustainable Awards in Finance in its Environmental and Social categories.

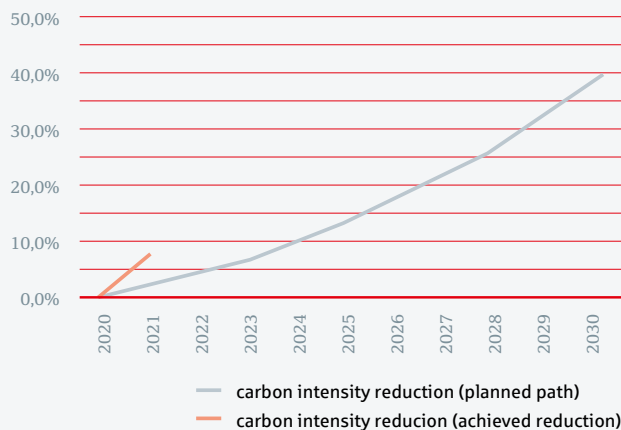
### Looking back...

At the time of publication, it has been almost a year since the first SLB was issued by a commercial bank and Berlin Hyp’s first Sustainability-Linked Bond Report is being published at the same time as its annual financial statement. The result is quite impressive: First the Bank managed to significantly increase the share of real estate financing with available energy certificates in its portfolio. While the transparency ratio was at 35 per cent of the financing volume on 31 December 2020, this figure climbed to 45 per cent by the same date in 2021.

This reduction was made possible in part due to a qualitative improvement in the Bank’s loan portfolio with regard to the energy efficiency of the properties which it finances. This was also partly due to decarbonisation of the energy mix in almost all countries where Berlin Hyp finances properties.

Since Berlin Hyp does not want to achieve its ambitious 40 per cent goal by replacing approximate values with the energy demand or consumption values from the energy performance certificates, the value for the base year of 2020 first had to be retrospectively adjusted by “savings” which were only derived from the high transparency ratio. After all, this still applied to CO<sub>2</sub> emissions of over 48,000 tonnes. The adjustment meant that the base year CO<sub>2</sub> intensity of 38.62 kg CO<sub>2</sub>/m<sup>2</sup>/a was corrected to 37.11 kg CO<sub>2</sub>/m<sup>2</sup>/a. However, the reduction in CO<sub>2</sub> intensity to 34.29 kg CO<sub>2</sub>/m<sup>2</sup>/a achieved in the 2021 reporting year still represents an improvement of 7.6 per cent and is therefore significantly above Berlin Hyp’s self-defined target path.

**Strategic Performance Target – Carbon Intensity Reduction by 40%**



## ...and looking forward

In 2021, with its Sustainability-Linked Bond Framework and the first bond issued under it, Berlin Hyp has taken a major step towards expanding its presence on the ESG capital market. Nevertheless, it is and will remain essential for the Bank to continue to develop in the future. The Bank published one of these advancements outside the reporting period, in January 2022, when it presented its revised Green Bond Framework. In this new framework, previous energy efficiency criteria for eligible green assets are complemented by the EU Taxonomy requirements for buildings and construction activities, including “do no significant harm” criteria and a minimum standards for social protection. In doing this, the Bank is now one of the first commercial banks in Europe to have a taxonomy-compliant Green Bond Framework. However, this development is still by

no means complete with regard to the Bank’s ESG refinancing. An important topic for the future will be to also address social aspects in real estate financing with regard to the available products, particularly when it comes to exploring opportunities to promote affordable housing.



Any use of the generic masculine form naturally also includes individuals of all other genders.