

# BNG BANK SOCIAL BOND

## FRAMEWORK OVERVIEW AND SECOND OPINION BY SUSTAINALYTICS

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**Farnam Bidgoli (London)**

Manager, Advisory Services

[farnam.bidgoli@sustainalytics.com](mailto:farnam.bidgoli@sustainalytics.com)

(+44) 20 3514 3127

**Tim Langer (London)**

Responsible Investment Adviser, Institutional Relations

[tim.langer@sustainalytics.com](mailto:tim.langer@sustainalytics.com)

(+44) 20 3695 9525

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## 1. PREFACE

BNG Bank, a Dutch bank for the public sector, has engaged Sustainalytics to provide a second opinion on its social bond issuance and the bond's social credentials. The social bond aims to fund the top social housing associations in the Netherlands. As a part of this engagement, Sustainalytics held conversations with various members of BNG Bank's management team to understand the social impact of their lending, and planned use of proceeds for the issuance. Sustainalytics also reviewed relevant public and internal documents, including the Telos Rating Methodology, which determined the eligibility criteria for the bond proceeds. This document contains two sections: Framework Overview - a summary of the BNG Bank Social Bond framework, developed in collaboration with Telos, the Sustainability Center of Tilburg University; and Sustainalytics' Opinion - an opinion on the framework.

## 2. INTRODUCTION

BNG Bank's Social Bond takes an innovative approach that directs bond proceeds to social housing associations with a focus on deprived neighbourhoods in the Netherlands. BNG Bank is using the methodology developed by Telos, the Sustainability Center of Tilburg University, for ranking social housing associations based on their sustainability performance, and their degree of investment in neighbourhoods with large social challenges. Sustainalytics reviewed the framework developed by Telos for BNG Bank's Social Bond. The framework is aligned with the International Capital Market Association (ICMA)'s Social Bond Guidance.

## 3. FRAMEWORK OVERVIEW

### 3.1 Use of Proceeds

#### 3.1.1 Eligibility Criteria: The Telos Rating Methodology

Bond proceeds will be used by BNG Bank to lend to sustainable social housing associations with a focus on deprived neighbourhoods in the Netherlands, as identified by the Telos methodology.

Anchored broadly in the UN Sustainable Development Goals, Telos developed a methodology for selecting social housing associations with a focus on deprived neighbourhoods that would be eligible for funding through BNG Bank's Social Bond. This methodology is based on two pillars:

1. The sustainability score of the social housing association, as defined below;
2. Investments by the social housing association in the most socially deprived neighbourhoods.

Social housing associations were selected based on their sustainability scores and on the degree to which they invest in the most socially deprived neighbourhoods. These 200 selected social housing associations were then grouped into 10 classes to ensure that social housing associations of various sizes, with various property ages, and with various types of dwellings were finally chosen. Based on this methodology Telos identified the eligibility criterion for use of bond proceeds, which is defined as the top 15 social housing associations within the ten social housing association classes. After adjusting for overlap between classes, Telos finalized 92 or 25.5% of all Dutch social housing associations as top performing social housing associations with a focus on deprived neighbourhoods. Each of the two pillars is discussed in detail below.

### *Sustainability Score*

The Telos methodology for calculating the Sustainability Score for social housing associations incorporates four 'capitals': Ecological Capital, Social Capital, Economic Capital, and Internal Business of the social housing association. Each of these capitals has corresponding themes and indicators. In total, the framework scores social housing associations on the four capitals, 12 themes, and 31 impact indicators. A full list of these indicators is provided in Appendix 1. The data for these indicators will be collected from Dutch central national databases such as Dutch Association of Social Housing Organisations (AEDES) and the Dutch Central Bureau of Statistics.

Each indicator is scored on a range consisting of five standard performance brackets. While the minimum and maximum values of the range are defined differently according to individual indicator characteristics, the performance brackets are comparable across all indicators. Social housing associations are rated on actual performance vis-à-vis the indicators, and placed in one of the five standard performance brackets. Indicator level scores are then aggregated to theme scores, which are subsequently equally weighted and aggregated to produce capital scores. The overall Sustainability Score of a social housing association is the mean value of its four capitals. The structure of this framework ensures that social housing associations are evaluated comprehensively, on both their operation and their services. The themes that social housing associations are evaluated on range from governance and energy, to physical and economic accessibility and tenants' satisfaction.

### *Investments in Socially Deprived Neighbourhoods*

The second pillar of the Telos methodology assesses the degree to which social housing associations invest in neighbourhoods with the largest social challenges. Neighbourhoods with the largest social challenges are those where (i) social housing associations own more than 25% of the housing stock, or (ii) greater than 40% of the total number of households are poor (as defined by Statistics Netherlands). A high level of investment is defined as spending greater than 331 euro per 100 rental units in the time frame 2012-2014. Telos has defined this threshold based on the average amount of spending over a period of three years (2012-2014) by social housing associations according to the data available at Statistics Netherlands.

Dutch social housing associations were divided into four categories based on their level of investment in residential improvements in a neighbourhood and the level of social challenges in that neighbourhood. These categories are outlined in Table 1.

## **3.2 Project Evaluation and Selection Process**

Selection of social housing associations is based on the two pillars of the Telos rating methodology- sustainability scores, and investments in socially deprived neighbourhoods. Social housing associations with the highest sustainability scores in each category are selected as eligible for funding through BNG Bank's Social Bond. Table 1 provides details on the proportion of social housing associations selected from each category.

**Table 1: Proportion of social housing associations selected from four categories**

<b>Category Number</b>	<b>Category Description</b> <b>Social Housing Associations with:</b>	<b>Total number of social housing associations in each category</b>	<b>Proportion of social housing associations selected from each category</b>
<b>1</b>	High level of investments in neighbourhoods with the largest social challenges	96	83% (i.e. 80 out of 96)
<b>2</b>	High level of investments in neighbourhoods with smaller social challenges	85	71% (i.e. 60 out of 85)
<b>3</b>	Low level of investments in neighbourhoods with smaller social challenges	93	43% (i.e. 40 out of 93)
<b>4</b>	Low level of investments in neighbourhoods with the largest social challenges	87	23% (i.e. 20 out of 87)

As Table 1 illustrates, the highest proportion of social housing associations were chosen from the highest impact categories, i.e. social housing associations with high levels of investments in residential improvements. Telos’ impact rationale is that a high level of investment in residential improvements creates a safe neighbourhood through increasing the attractiveness of area, reducing violence, and improving waste collection.

From an impact perspective, there are three key reasons Telos also selected social housing associations from categories three and four, the categories with lower levels of investment:

1. Firstly, Dutch social housing associations operating in neighbourhoods with smaller social challenges still serve vulnerable populations in those areas.
2. In addition to marginalized and vulnerable populations, Dutch social housing associations also serve the Dutch middle class. The impact of social associations with high sustainability scores serving less vulnerable populations should not be ignored.
3. Finally, the level of investment of social housing associations identified by Telos is reflective of investment only in the past three years. Social housing associations that are currently identified as having a low level of investment may not have had the same low level of investment outside the 2012-2014 timeframe chosen by Telos.

As such, a current low level of investment by these social housing associations, or investment in a neighbourhood with smaller social challenges, does not necessarily indicate that these associations do not have a significant social impact. Additionally, the number and diversity of social housing associations required to fully represent all 10 classes was achievable only by selecting social housing associations with high sustainability scores across all four impact categories.

### 3.3 Management of Proceeds

The loans to which the proceeds will be allocated will be earmarked separately by tagging them with the ISIN code of the relevant BNG Bank sustainability bond. This ISIN code will facilitate easy identification of the loans that qualify based on the eligibility criterion.

### 3.4 Reporting

#### Allocation Reporting

BNG Bank has disclosed that the loans to which the bond proceeds will be allocated will be subject to internal and external auditing. Additionally, BNG Bank will also provide an annual performance report that will include details on disbursements of bond proceeds.

#### Impact Reporting

In its annual performance report, BNG Bank will report on impact at the following three levels:

1. Sustainability scores of social housing associations funded;
2. Level of investments of social housing associations in residential improvements;
3. Outcomes relating to the environmental and social characteristics of neighbourhoods where social housing associations own property.

BNG Bank will report on the sustainability scores of social housing associations funded, and the level of investments of social housing associations in residential improvements using the 31 indicators of the Telos framework, as described above.

Additionally, BNG Bank will continue to work with Telos throughout 2016 to develop a methodology to report on outcomes in neighbourhoods where social housing associations own property. Examples of such outcomes indicators include employment rate in neighbourhood, number or proportion of poor households in neighbourhood, and availability of schools in neighbourhood.

## 4. SUSTAINALYTICS' OPINION

### Adherence to Social Bond Guidance 2016

Principle	In line with the Social Bond Guidance 2016	Highlights or best practices (Examples)
<b>Use of Proceeds</b>	Yes	Proceeds of the bond will be used for general purposes by the social housing associations, including the building, maintenance and renovation of rental dwellings in the Netherlands. BNG Bank will not be selecting specific projects to be funded by the social housing associations, and the eligibility criterion for the use of proceeds is based on the sustainability performance of the borrowing entity rather than on the nature of the projects to be funded. Nonetheless, Sustainalytics is of the opinion that the bond will generate positive impact by channeling funds to projects managed by social housing associations in largely socially deprived areas. Furthermore, the housing associations' investments and activities are subject to external audit by the Dutch Authority of Housing Associations.
<b>Project selection process</b>	Yes	The selection process to identify the top 15 sustainable social housing associations as rated by Telos from each of the ten classes is robust. The top 15 social housing associations within each class, after adjusting for overlap, constitute the top quartile (25.5%) of total Dutch social housing associations, which is reflective of a best-in-class approach to select top performers. Additionally, Telos' methodology effectively balances social housing associations' own sustainability performance with the nature of the expected impact of their services. High impact social housing associations are further narrowed down by their sustainability scores, and selection of lower impact social housing associations is offset by their high sustainability performance.
<b>Management of Proceeds</b>	Yes	Sustainalytics is of the opinion that BNG Bank has sufficient oversight over the management of proceeds, and there is a formal and detailed process to identify loans that qualify based on the eligibility criterion. This is in line with market best-practices.
<b>Reporting</b>	Yes	BNG Bank's commitment to have audits carried out by external auditors is in line with market best practices for social bonds. Additionally, the outcomes level reporting that will be developed by BNG Bank and Telos will facilitate a better understanding of improvements achieved through funding social housing associations with a focus on deprived neighbourhoods. Sustainalytics is of the opinion that BNG Bank's impact reporting is robust and aligned with market best-practices.

## 5. CONCLUSION

Sustainalytics views BNG Bank's methodology to select social housing associations with a focus on deprived neighbourhoods as innovative and robust. The use of proceeds clearly seeks to achieve positive socio-economic outcomes for target populations, as demonstrated by the consideration of both the sustainability performance of social housing associations and their investments in socially deprived neighbourhoods. Additionally, BNG Bank's commitment to transparently and comprehensively report on impact is aligned with market best practice. Based on the above considerations, Sustainalytics is of the opinion that BNG Bank's social bond framework is credible, and will direct funding towards improving the quality of affordable housing in the Netherlands.

## APPENDIX 1: IMPACT REPORTING INDICATORS

Indicators to report on (1) sustainability scores of social housing associations funded and (2) level of investments of social housing associations in residential improvements

Number	Indicator
1	Total investments in energy measures
2	Total maintenance costs
3	Tenants satisfaction
4	Costs of complaints services
5	Number of rental units per FTE
6	Interest coverage ratio
7	Losses on unrealized projects
8	Total risk
9	Total risk prognosis for 2017
10	Total risk prognosis for 2019
11	Total allocations within income limits 2011-2013
12	Energy label index
13	Expenses on quality of life (physical activities)
14	Percentage of proper allocations
15	Share of low rent dwellings
16	Share of affordable dwellings
17	Physically highly accessible dwellings
18	Rental price per point in housing valuation points system
19	Rental price as a percentage of the assessed value
20	Actual rent price as percentage of the maximum permitted rent
21	Expenses on quality of life (social activities)
22	Loss of rental income due to vacancy
23	Loss of rental income due to market conditions
24	Rent arrears
25	Remaining lifespan of property
26	New housing units realized
27	New housing units prognosis 2015-2019
28	Average amount of points in housing valuation points system
29	Standardized corporation exploitation value and rental price ratio
30	Standardized corporation exploitation value
31	Loan to value

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