

# **Erste Mortgage Bank**

## **Green Mortgage Bond Framework**

November

2021

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# 1. Introduction

## 1.1 Background

Erste Mortgage Bank Ltd. (hereinafter “Erste Mortgage Bank” or “Mortgage Bank” or “Issuer”) is the mortgage bank subsidiary of Erste Bank Hungary (hereinafter “Erste Bank” or “Parent bank”).

Erste Mortgage Bank was granted an establishment license by the National Bank of Hungary on 25 November 2015 and received its operational license on 30 June 2016.

Since 1997 the founder of Erste Mortgage Bank, Erste Bank is a member of the Erste Group managed by Erste Group Bank AG. Erste Group Bank AG was founded as the first savings bank in Austria in 1819. Since 1997 the international Erste Group has become one of the largest financial service providers in East Europe.

Registered seat, legal form of the Issuer and the law governing its operation and the country of its incorporation:

Registered seat of the Issuer: 1138 Budapest, Népfürdő u. 24-26.,

Legal form of the Issuer: closed company limited by shares

Law governing the operation of the Issuer: Hungarian law

The country where the Issuer is incorporated: Hungary

The Issuer is entered into the registry of the Metropolitan Court of Budapest as Court of Registration under company registration no.: 01-10-048682.

Erste Mortgage Bank is a subsidiary in 100% ownership of Erste Bank. The financing model of the Issuer is exclusively focused on refinancing, desiring to grant access to Erste Bank Hungary and other partner banks to long-term capital market resources by issuing mortgage bonds.

Issuer’s functional concept is based on operational integration with the Parent bank. Its goal is to achieve maximum synergies within the Erste Bank, meaning optimal use of know-how. Erste Bank declared contractual financial support for Erste Mortgage Bank to keep its liquidity and capital adequacy ratios above regulatory limits, but does not guarantee to cover its obligations. Erste Mortgage Bank’s main purpose in issuing covered bonds is to secure long-term financing by issuing covered bonds at a lower cost. The use of covered bonds to refinance mortgage lending also increases the Parent bank’s financial safety by ensuring the appropriate maturity structure of assets and liabilities. Erste Mortgage Bank is the fourth largest issuer of HUF denominated covered bonds in Hungary according to market share of 30.06.2021.

Erste Mortgage Bank is committed to sustainable development as it responds to the diverse needs of its market, the society and the natural environment.

Erste Mortgage Bank strategy is to issue covered bonds to refinance the mortgage loans granted to individual customers, providing a diversification in funding sources and a prolongation in the maturity profile of the liabilities side of the balance sheet.

Erste Mortgage Bank's key task is the issuance of covered bonds, which constitute the source of long-term refinancing of loans granted by the Parent bank and other partner banks that are secured by property. Erste Mortgage Bank's mission is to provide:

- for partner banks: refinancing loan products for financing of property
- for investors: long-term covered bonds with a high level of safety

## 1.2 Rationale

Erste Bank Hungary (EBH) as the parent bank of Erste Mortgage Bank is committed to making banking more sustainable as a better bank contributing to a better world and to making sustainability an integral part of its business activities.

EBH is dedicated to decrease its carbon footprint therefore it is working on a de-carbonization plan to achieve carbon neutral operation. We are facing several challenges due to climate change what EBH is trying to minimize by integrating environmental risk measurement into its risk framework. As sustainability is becoming more and more important the demand for green products is increasing. As a response to this, EBH is widening its green loan offer like dedicated green mortgage loans for energy efficient houses and apartments. Meanwhile the need to finance the green transformation of the economy creating new business opportunities for EBH.

Erste Group intends to contribute to the development of the Green Bond market as it is an important tool for channeling more investments towards climate change mitigation. Erste Mortgage Bank, as Erste Group member, believes that Green Bonds offer transparency and traceability to investors who wish to allocate funds to green assets. By issuing green covered bonds, Erste Mortgage Bank hopes to broaden its investor base by attracting investors that seek to focus their investments towards environmentally friendly housing buildings. In addition, green covered bonds create the perfect opportunity to connect sustainable parts of the business with dedicated investor demand, the green objectives of the bond is in full alignment with group sustainable policy, with expected Erste ESG strategy and follows closely the UN SDG-s / EU environmental objectives. Moreover, by issuing green covered bonds focused on energy efficiency, the Mortgage Bank, its clients and investors contribute to Hungary's housing loan's energy saving targets.

Erste Mortgage Bank has developed this Green Mortgage Bond Framework in accordance with the Climate Bond Standard, in alignment with market best practice in terms of transparency, impact reporting and commitments, and this framework follows the Climate Bonds Standard. The CBI Standard determine the green certification of the financed properties essentially on the basis of their energy efficiency.

## 2. Erste Mortgage Bank Green Bond Summary

Erste Mortgage Bank has created this Green Mortgage Bond Framework in accordance with Climate Bond Standard V 3.0<sup>1</sup>, issued by the Climate Bonds Initiative, to be able to issue green covered bonds to refinance mortgages for energy efficient residential properties with lower energy needs and consumption.

The Climate Bond Standard are voluntary guidelines that recommend transparency and disclosure and promote integrity in the development of the Green Bond market by clarifying the approach for issuance of a Green Bond. In alignment with the latest Climate Bond Standard, Erste Mortgage Bank Green Mortgage Bond Framework is presented through the following key pillars:

- Use of Proceeds
- Process for Project Evaluation and Selection
- Management of Proceeds
- Reporting
- External review

For each Green Bond issued, (i) Use of Proceeds (ii) Project Evaluation and Selection (iii) Management of Proceeds, (iv) Reporting, and (v) External review will be adopted subject to and in accordance with this Green Mortgage Bond Framework as amended from time to time. Any major amendments shall be a subject to an updated, independent third party assurance report.

This framework will apply to any Green Mortgage Bond issued by Erste Mortgage Bank after its publication.

The Green Mortgage Bond Framework will be reviewed upon any change in the requirements applicable to green mortgage bonds or in the legislative environment. If the Mortgage Bank modifies its Green Mortgage Bond Framework as a result of a review, this will not affect its commitment regarding already issued green mortgage bonds. Any tightening or easing of the conditions will only apply to securities issued after the publication of the new version of the Green Mortgage Bond Framework.

## 3. Use of Proceeds

Erste Mortgage Bank Ltd. intends to allocate the net proceeds of the green mortgage bonds to a loan portfolio of new and existing mortgages for energy efficient residential buildings in

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<sup>1</sup> <https://www.climatebonds.net/climate-bonds-standard-v3>

Hungary (Residential Green Buildings). The eligible loans are to be funded by an allocation of the Green Mortgage Bond proceeds.

When mortgage bonds are backed by the commitment of future green mortgage loans, Erste Mortgage Bank aims at filling up the coverage up to 24 months after the issuance of green mortgage bonds.

After the achievement of the necessary green loan coverage, a continuous overcollateralization will be kept until the maturity of mortgage bonds in order to have sufficient buffer against any scheduled or unscheduled amortization of the green cover assets.

Any financing not classified within this Green Covered Bond framework will not be refinanced with the issue proceeds from a green covered bond.

Erste Mortgage Bank determines that the nominated assets shall not be nominated to other Certified Climate Bonds, Certified Climate Loans, Certified Debt Instruments, green bonds, green loans or other labelled instruments.

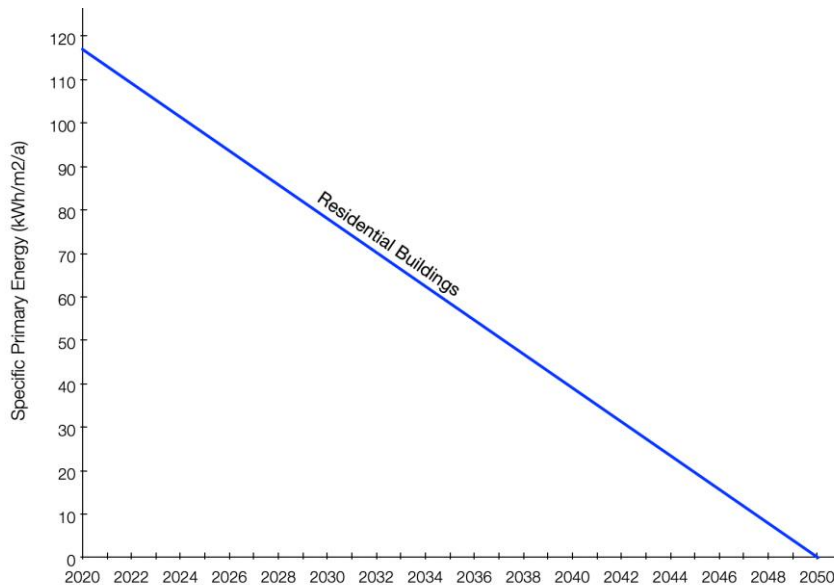
### **3.1 Criteria based on primary energy consumption**

Erste Mortgage Bank has relied on the support of external consultant as of CBI's Low carbon buildings criteria under the Climate Bond Standard to define the associated eligibility criteria and also took into account the EU Taxonomy requirements, relevant to Hungary.

The definition of eligible green residential buildings focuses on new or existing residential buildings representing the top 15% of low-carbon buildings in Hungary, where specific primary energy consumption published on an Energy Performance Certificate dated after January 1<sup>st</sup> 2016, meets or is below the Threshold defined by the midpoint between the beginning and end of the term of the mortgage bond on the reference trajectory.

In addition, in line with EU Taxonomy requirements, buildings built after January 1<sup>st</sup> 2022 need also to have at least 10 % lower primary energy consumption than the nearly zero energy building standard (NZEB) threshold.

The trajectories used to establish the hurdle rate for residential dwellings in Hungary is shown in the diagram below.



It can be seen that the hurdle rate starts at the 2020 baseline of primary energy consumption and falls over time. The rate of fall is determined to achieve net zero emissions in 2050. The hurdle rate is established from a trajectory defined by the 2020 baseline of primary energy consumption  $\leq 118 \text{ kWh/ m}^2 \text{ /annum}$  and a 2050 target of  $0 \text{ kWh/ m}^2 \text{ /annum}$ .

As an example of midpoint calculation, if Erste JZB plans to issue an 8-year green mortgage bond in the fourth quarter of 2021, then the bond will have an arithmetic average of 2021 and 2029, ie 2025. Currently, the expected specific primary energy consumption for this year, ie 2025, (PE)  $\leq 98 \text{ kWh/ m}^2 \text{ / year}$ . Thus, only mortgage loans with real estate collateral with a primary energy consumption of  $98 \text{ kWh/ m}^2 \text{ / year}$  or less can be collateral for green mortgage bonds. If the building related to the mortgage loan was built after January 1<sup>st</sup> 2022, it needs also to have at least 10 % lower primary energy consumption than the NZEB threshold in Hungary, ie.  $90 \text{ kWh/ m}^2 \text{ /year}$  or less.

These eligibility criteria for Hungary are subject to periodic review and may be amended from time to time by the Climate Bonds Standard.

For the avoidance of doubt, any future changes to the eligibility criteria will not apply to Green Mortgage Bonds issued before the date of the change.

#### 4. Process for Project Evaluation and Selection

A dedicated Green Mortgage Bond Committee has been established to create this Green Mortgage Bond Framework, manage any future updates to the Framework, including expansions to the list of Eligible Categories, and oversees its implementation. The committee members of Mortgage Bank are: CEO, CRO, Head of Treasury and Capital Markets department, Head of Property Valuation department, Head of Refinancing and Cover Pool Register department. In addition, the senior legal expert of Mortgage Bank and the Head of Mortgage

Loan Products of EBH are invited permanently to the meetings. The Green Mortgage Bond Committee meets on regular basis (at least annually).

The major task of the committee to oversee the entire Green Mortgage Bond process, including the evaluation and selection of eligible loans. The committee discusses the verifier's reports and recommendations in relation to the Green Mortgage Bond Program. It approves the Green Mortgage Bond Framework and all its future amendments and reports directly to the Management Board of Erste Mortgage Bank. Green Mortgage Bond Committee is acting according to the Organizational and Operational Regulations of Erste Mortgage Bank.

After mortgage loan disbursement by a partner bank, the partner bank offers individual mortgage loans for refinancing to Erste Mortgage Bank. Erste Mortgage Bank and its Coverage Supervisor approve the mortgage loans to be eligible to the cover pool register. The eligibility criteria of mortgage loans in general are determined in Act no. XXX of 1997 on Mortgage Banks and Mortgage Bonds as well as in individual refinancing agreement of each partner bank. The conditions set in the refinancing agreement may determine stricter rules than the expectations of the Act no. XXX of 1997 on Mortgage Banks and Mortgage Bonds. Erste Mortgage Bank is responsible for identification and record keeping of new and existing mortgages that meet the eligibility criteria. As Erste Mortgage Bank only focusing on refinancing activity with exclusive scope on residential mortgage loans, the cover pool register does not include any corporate loans.

Both in case of future green loans which will be originated after Erste Mortgage Bank's issuance and in case of green loans which are existing at the time of Erste Mortgage Bank's issuance the Refinancing and Cover Pool Register department will individually validate the mortgage loans offered for refinancing according to the manual and eligibility criteria based on the adopted methodology by the Green Mortgage Bond Committee. A mortgage register of eligible green loans will be kept by Erste Mortgage Bank available daily for green covered bond funding with clear assignment of green cover assets to their relevant mortgage bond.

## **5. Management of Proceeds**

The proceeds from the issuance of Green Mortgage Bonds will be allocated within 24 months to a portfolio of loans that meet the use of proceeds eligibility criteria and in accordance with the evaluation and selection process presented above, the Eligible Green Loan Portfolio.

Erste Mortgage Bank intends to designate sufficient eligible loans in the Eligible Green Loan Portfolio to ensure an overcollateralization of the outstanding balance of Eligible Green Loans in terms of the total outstanding balance of all Green Mortgage Bonds. For each Green Mortgage Bond issuance, where necessary, additional Eligible Green Loans will be added to this Eligible Green Loan Portfolio to ensure the sufficient and timely allocation of the incremental net proceeds.



If a loan is repaid or otherwise ceases to fulfil the eligibility criteria during the life of the Green Mortgage Bonds, Erste Mortgage Bank will remove the loan from the Eligible Green Loan Portfolio and replace it as soon as reasonably practicable. Erste Mortgage Bank refinancing model is based on a daily matching of refinancing cash-flows, i.e. future principal cash-flows of mortgage loans should match with the cash-flows of the refinancing loans at any time. In order to maintain exact matching, any changes regarding the mortgage loan cash-flow should be reported by the partner banks to Erste Mortgage Bank, so that the respective refinancing loan can be fully and immediately adjusted.

Whenever the Green Mortgage Bond is issued before the green cover assets are accumulated, Erste Mortgage Bank will have an unallocated fund. Erste Mortgage Bank will hold and/or invest any unallocated Green Mortgage Bond net proceeds, at its own discretion, in its liquidity portfolio into Hungarian government securities and any other money market instruments defined in the relevant international and Hungarian standards and regulations and it could also top up into a special credit line set up with Erste Bank to finance exclusively green refinancing activity. Erste Mortgage Bank commits that the unallocated proceeds will not be used to finance any other activities including refinancing non-green mortgage loans.

The Erste Mortgage Bank will provide information on the unallocated proceeds and their investment forms on a regular basis in relation to each series of Mortgage bonds.

## **6. Reporting**

The Climate Bond Standard require Green Bond issuers to provide information on the allocation of proceeds. In addition to information related to the green residential buildings to which Green Bond proceeds have been allocated, the Climate Bond Standard recommend communicating on the expected impact of the projects.

Erste Mortgage Bank commitment that the unallocated proceeds will not be used to finance any other activities including refinancing non-green mortgage loans and will align the reporting with the portfolio approach described below. The reporting is based on the outstanding Eligible Green Loan Portfolio and the numbers will be aggregated for all Green Covered Bonds outstanding.

Erste Mortgage Bank intends to report to investors within one year from the date of a Green Covered Bond transaction and annually thereafter, until the covered bonds have been fully repaid.

### **6.1 Allocation Reporting**

Allocation reporting will be available to investors within one year and annually thereafter, until the bonds have been fully repaid. The report will provide, on a portfolio basis, reporting on indicators such as:

- the total amount of outstanding proceeds allocated to eligible loans
- the number of eligible loans and distribution of loans according to loan purposes
- the balance of unallocated proceeds and the form of its holdings.

## **6.2 Impact Reporting**

Erste Mortgage Bank commits on a best effort basis to report annually and on a timely basis and until the bonds have been fully repaid, on climate benefits associated to the Green buildings of eligible loans on:

- Estimated annual primary energy savings in MWh
- Estimated annual GHG (Green House Gas) emissions avoided in tons of CO2 equivalent

Both allocation report and impact report will be made available on Erste Mortgage Bank website.

To offer maximum transparency to investors Erste Mortgage Bank will also strive to deliver such impact estimates in an investor presentation alongside with the issuance of each Green Mortgage Bond.

## **7. External review**

Erste Mortgage Bank decided to obtain accreditation of the CBI certificate for the envisaged green covered bond with Erste Mortgage Bank Green Mortgage Bond Framework complying with Climate Bond Initiative's standard for residential buildings.

KPMG, an approved CBI verifier, has been appointed to confirm the framework's conformance with CBI's standard and certification methodology.

### **7.1 Independent third party assurance report**

KPMG has provided an independent limited third party assurance report related to the green bond and made a pre-issuance verification letter on the use of proceeds.

The Climate Bond Initiative Pre-Issuance certificate for Erste Mortgage Bank green mortgage bond has been issued and it is published on Erste Mortgage Bank website.

## **7.2 Verification post issuance**

Erste Mortgage Bank requested on an annual basis, starting one year after issuance and until full allocation, a limited assurance report of the allocation of the covered bond proceeds to eligible assets, provided by KPMG (or any subsequent external verifier). KPMG (or any subsequent external verifier) will issue annual verification starting from one year after post issuance verification until maturity of green mortgage bond.

## **8. Disclaimer**

This document has been prepared by Erste Mortgage Bank and was drafted for the sole purpose of presenting its Green Mortgage Bond Framework. This document is being delivered for general information purposes only and no reliance should be placed on the completeness of the information contained herein.

This document may contain statements about future events and expectations that are forward looking statements. None of the future projections, expectations, estimates or prospects in this document should be taken as forecasts or promises nor should they be taken as implying any indication, assurance or guarantee that the assumptions on which such future projections, expectations, estimates or prospects have been prepared are correct or exhaustive or, in the case of the assumptions, fully stated in the document.

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