Green Tagging: Mobilising Bank Finance for Energy Efficiency in Real Estate

REPORT FROM THE BANK WORKING GROUP 2017

Co-authored by Peter Sweatman and Nick Robins
Climate Strategy & UN Environment Inquiry

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Executive Summary

This report presents the findings and recommendations from a survey of green tagging practices among 10 European banks: ABN Amro, BBVA, Berlin Hyp, HSBC, ING, Lloyds, SEB, Suedtiroler Volksbank, Triodos and UniCredit. The survey shows that many are now active in identifying, analysing and promoting green finance ('green tagging') in their lending and debt capital markets operations. But even among these leaders, the process remains at a relatively early stage of its evolution. Actions by individual banks, banking associations and policy makers could help to consolidate and scale up this practice both to enable banks to better serve their clients and also enable the European Union to deliver its climate, energy and sustainability ambitions.

The concept of green tagging emerged in 2016 as a way to enable the expansion of financing investments with positive environmental attributes, improve management information and disclosure as well as strengthen the resilience of loan portfolios. Real estate energy efficiency in the loan books of banks was considered a useful place to start; given its importance as a proportion of bank balance sheets, its importance in climate change terms and the existence of established systems for energy performance labelling as a basis for tagging. Also if banks tagged their real estate and mortgage loans to existing energy and environmental standards, there would be a leap in market transparency on the flows of finance to energy efficient assets and products. This data would provide valuable information on the portfolios of energy efficient loans that could be packaged as asset backed securities and refinanced by green bonds, and it would also provide the basis for evaluating the financial performance of energy efficient loans relative to less efficient ones. The pace of change is clearly accelerating – particularly around real estate and energy efficiency – and is driven by a number of forces:

- **Financial innovation:** Banks are designing a new range of green finance products both in terms of lending, but also in debt capital markets and securitisation.
- **Policy priority:** Energy efficiency in buildings is the area where there is the greatest investment gap to deliver Europe's climate goals.
- **Market disclosure:** Initiatives such as the FSB's Task Force on Climate-related Financial Disclosures (TCFD) are prompting banks to become more focused on quantitative reporting on green finance.

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- **Financial regulation:** The EC's review of the European Supervisory Authorities concluded that the ESAs should now "promote sustainable finance, while ensuring financial stability". Sustainability is part of the new securitisation framework and is being taken forward by national regulators in France, Italy, Netherlands, Sweden and the UK.

This report seeks to provide practical insights into this fast-moving agenda by examining the current practices of 10 of Europe's leading banks[1]. It describes how they are approaching and developing a systematic approach to green tagging with a focus on commercial and residential real estate mortgage loans. Over one third of the banks surveyed are well advanced and have a functioning approach to green tagging, and 40% have launched green products, and all are keen to see this market develop. The key findings of the survey are:

- **first, new green business opportunities are a stronger incentive than improved risk management for banks at present:** Led by commercial real estate groups and wholesale finance, in many cases, bank units who perceive green tagging as leading to increased revenues are more advanced than banks who perceive green tagging as leading to better risk management and lower losses.
- **second, there is no clear definition of "green", but energy efficiency and greenhouse gas emissions are the green attributes seen as most material by banks and their stakeholders:** Banks use various taxonomies of green including their own and those offered by the Climate Bonds Initiative and others. There is no standard for what constitutes "green" although it is clear that energy efficiency and greenhouse gas emissions intensities are seen as more material by banks than more subjective or location specific attributes like biodiversity or land-use factors.
- **third, the financial case for green is sufficiently compelling for banks to undertake green tagging without a perfect, multi-annual green performance data history:** Safer decisions are made with a deeper and broader set of data upon which to base them, and more data substantially de-risks such decisions. However, leading banks are sufficiently convinced of the benefits of green assets, and the opportunities and insights offered through green tagging, that they are implementing it, and providing improved pricing for client's green actions, to create the data they will need to determine the quality of these decisions.

[1] ABN Amro, BBVA, Berlin Hyp, HSBC, ING, Lloyds, SEB, Suedtiroler Volksbank, Triodos and UniCredit.

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- **fourth, there is a strong case for connecting green tagging with the maturing agenda on the links between sustainability factors and prudential regulation.** The inherent risks of non-green or assets with a low environmental performance are not a leading driver for banks to implement green tagging. There is also no penalty for banks which cannot reliably describe the environmental or climate impacts of their financing activities. One reason why commercial real-estate departments lead in green tagging is because in many countries, low energy performing buildings will cease to be legally rentable in the future, and therefore their value will be significantly impaired. This risk to bank clients and to bank lenders is a strong motivation for action.

- **fifth, financial institutions want to see stronger analytical foundation, investigating the correlations between financial performance in mortgage portfolios with energy performance (as a proxy for green):** Nearly all of the participating banks expressed interest in a further examination of the correlation between green performance and financial performance. While there are multiple barriers to such an examination (including Energy Performance Certificate data quality, data privacy, definition of green, time series and sample set of loans and availability of property energy performance data in some member states), project partners believe that this can be explored in further work. Based on these lessons, this report concludes by recommending five next steps for 2018:

  - ► **Assess the quantitative relationships between building performance and loan performance:** Market players and policymakers still lack more robust analysis of how energy performance of buildings related to loan performance. This would provide the foundation for better loan pricing, stimulus for market development and feed-into regulatory alignment.

  - ► **Build a common EU database of EPCs and other building data:** Tagging is currently held back by a variety of barriers that prevent easy matching of EPCs with loan data. Banks need more transparent availability of EPCs and buildings performance and energy usage data across Europe.

  - ► **Evaluate the links between building performance and regulatory capital:** In the context of the review of the European Supervisory Authorities, green tagging needs to be considered as an important tool for banks to understand the environmental exposures in their balance sheets.

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- ► **Focus on real estate as a pilot for a common classification system:** Efficient markets require shared protocols for defining financial attributes. Work is underway for a common EU classification system for sustainable assets. After renewable energy, real estate offers a financially sizeable and environmentally significant sector to focus on for convergence.
- ► **Connect green tagging with the new EU securitisation rules:** To help implement Article 103a, banks could begin to tag the energy performance of the underlying property as a voluntary data field.

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