Second Party Opinion

NEPI Rockcastle Sustainability-Linked Financing Framework

Oct. 19, 2023

Editor's note: This SPO report is based on S&P Global Ratings' "Analytical Approach: Second Party Opinions and Transaction Evaluations" dated Dec. 7, 2022, which was partly superseded by S&P Global Ratings' "Analytical Approach: Second Party Opinions: Use of Proceeds," dated Jul. 27, 2023, following the launch of our integrated use-of-proceeds SPOs. For more information on how we are managing the post-launch grace period, please see "S&P Global Ratings To Launch Integrated SPOs Soon".

NEPI Rockcastle N.V.(NEPI) is a property company operating in the Central and Eastern European (CEE) region. It was formed in 2017 through the merger of New Europe Property Investments and Rockcastle Global Real Estate Company Limited, with each of them incorporated in 2007 and 2012, respectively. The company's property portfolio was valued at €6.6 billion at the end of December 2022. It has a strong focus on retail (95% of the portfolio) and minor exposure to development projects (4% of portfolio value) and office and industrial assets (1% combined). It operates in nine CEE countries, particularly the Romanian and Polish markets (respectively 36% and 28% of the portfolio value), as well as Hungary (9%), Slovakia (8%), Bulgaria (8%), Croatia (4%), Czech Republic (3%), Serbia (2%), and Lithuania (2%).

In our view, NEPI Rockcastle's Sustainability-Linked Financing Framework, published on Oct. 19, is aligned with:

✔ Sustainability-Linked Loan Principles, LMA/LSTA/APLMA, 2023

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Issuer's Sustainability Objectives

In 2022 NEPI reviewed its sustainability strategy and formalized a roadmap to achieve its goals by 2030. The company has prioritized the following strategic pillars i) invest in healthy and sustainable buildings, ii) be a trusted partner for stakeholders, and iii) create an attractive, professional, and ethical work environment. Climate-related topics are the company's most material issues according to its recent materiality assessment. NEPI's board of directors endorses the company's carbon reduction pathway, which we view as a strength. NEPI plans to reduce its greenhouse gas emissions and reach its climate goals of reducing its operations' carbon footprint by 70% and embedded carbon by 30% by 2030 compared to 2019. It is also working to improve its supply chain by following principles of sustainable procurement and assessing suppliers on their environmental, social, and governance commitments.

NEPI has developed a sustainability-linked financing framework to further align its funding strategy with its corporate sustainability commitments. The framework includes loans and revolving credit facilities, which we understand will incorporate economic characteristics that can vary depending on the achievement of the Sustainability Performance Targets (SPTs).

Selected Key Performance Indicators (KPIs) And Sustainability Performance Targets (SPTs)

KPI	SPT	Baseline	2022 performance
Reduce the intensity of greenhouse gas emissions (scopes1 and 2) from operations	Decrease scopes 1 and 2 GHG emissions intensity by 40% during 2024-2030, compared to the 2022 baseline	18.726 kg CO2 e/ sqm (2022)	18.726 kg CO2 e/ sqm (2022)
Common areas energy intensity reduction	Decrease energy intensity in common areas by 30% during 2024-2030, compared to the 2022 baseline	100.6 kWh/m2 (2022)	100.6 kWh/sqm (2022)

Second Party Opinion Summary

Selection of key performance indicators (KPIs)

Alignment ✔ NEPI Rockcastle's sustainability-linked financing framework is aligned with this component of the SLLP.

		Not aligned	Aligned	Strong	Advanced
KPI 1	Reduction of the intensity of greenhouse gas emissions (scopes 1 and 2) from operations		**Aligned**		
KPI 2	Common areas energy intensity reduction		**Aligned**		

Calibration of sustainability performance targets (SPTs)

Alignment ✔ NEPI Rockcastle's sustainability-linked financing framework is aligned with this component of the SLLP.

		Not aligned	Aligned	Strong	Advanced
SPT 1	Decrease scopes 1 and 2 greenhouse gas emissions intensity by 40% during 2024-2030, compared to the 2022 baseline		**Aligned**		
SPT 2	Decrease energy intensity in common areas by 30% during 2024-2030, compared to the 2022 baseline		**Aligned**		

NEPI Rockcastle's sustainability-linked financing framework includes annual intermediary targets for each SPT.

Instrument characteristics

Alignment ✔ NEPI Rockcastle's sustainability-linked financing framework is aligned with this component of the SLLP.

The company will detail the structural characteristics of instruments issued under this framework in the corresponding loan documentation. This will include KPIs, SPTs, calculation methodology, the target observation date, and the size of the step-up and or step-down adjustments. Recalculations in baselines, KPIs, SPTs, and their values could be caused by changes to the corporate structure, regulatory changes, or methodology changes. NEPI will report these in its annual Sustainability-Linked Progress Report.

Reporting

Alignment ✔ NEPI's sustainability-linked financing framework is aligned with this component of the SLLP.

	Not aligned	Aligned	Strong	Advanced
Score			**Strong**	

NEPI will report on the performance of the KPIs and the SPTs, as well as relevant methodologies and baselines, the recalculation of baselines, the verification report of the KPI performance against the SPTs, and any other information it deems relevant. This information will be included in its annual Sustainability-Linked Progress Report.

Post-issuance review

Alignment ✔ NEPI's sustainability-linked financing framework is aligned with this component of the SLLP.

NEPI will obtain external and independent verification of the performance of its KPIs relative to the SPTs. Failure to achieve said verification by the dates outlined in the loan documentation will result in an automatic adjustment to the financial characteristics.

Framework Assessment

Selection of key performance indicators (KPIs)

The Principles make optional recommendations for stronger structuring practices, which inform our relevancy opinion as aligned, strong, or advanced. For each KPI, we consider how relevant the KPI is for sustainability by exploring the clarity and characteristics of the defined KPI; its significance for the issuer's sustainability disclosures; and how material it is to the issuer's industry and strategy.

✔ NEPI Rockcastle's sustainability-linked financing framework is aligned with this component of SLLP.

KPI 1	Reduction of the intensity of greenhouse gas emissions (scopes 1 and 2) from operations	Not aligned	**Aligned**	Strong	Advanced

We view NEPI's KPI 1 as aligned. Its objective, scope, and calculations are clearly articulated in the framework. The KPI, aimed at reducing scopes 1 and 2 emissions intensity, contributes to climate change mitigation, is in line with the company's sustainability strategy, and addresses an important sustainability issue that the real estate sector faces. The KPI covers all the properties that the company owns and operates, excluding assets under construction, which do not represent a significant amount of its portfolio.

The KPI is calculated using total scopes 1 and 2 emissions divided by the average annual common areas. Common areas include service and technical areas, shared areas, and shared equipment. The company follows the European Real Estate Association (EPRA) reporting guidelines for the normalization of the KPI, which we view positively as it provides better transparency to the market and allows for external benchmarking. NEPI calculates its scopes 1 and 2 greenhouse gas emissions in accordance with the Greenhouse Gas Protocol, in line with common market practice. Scope 1 emissions include emissions coming from gas consumption in common areas. It does not include emissions stemming from refrigerants for air conditioning, which we view as a potential weakness as this could represent a considerable portion of emissions especially during the warmer months. Indirect scope 2 emissions stem from the use of purchased electricity, heating, and cooling for common areas. To reflect the energy procured for each location, the company uses a market-based approach for scope 2 accounting in the framework. We note that the KPI does not include scope 3 emissions. In our view, scope 3 emissions are relevant for the industry, particularly for retail malls, in which a considerable amount of energy consumption involves tenants' use of properties. We view the inclusion of scope 3 emissions and engagement with tenants as key enablers for the sector's decarbonization efforts. Therefore, we believe the inclusion of scope 3 as a KPI would have a greater impact on the company's and the sector's decarbonization efforts. We view favorably that the KPI in NEPI's framework is expressed as a sustainability outcome rather than a financial proxy.

Greenhouse gas emissions are one of the sector's largest environmental exposures because buildings mainly depend on energy to operate (see "Key Sustainability Factors: Real Estate," published July 20, 2021). Namely, the sector is responsible for approximately 40% of global greenhouse gas emissions, according to the International Energy Agency (IEA, 2022). This is because real estate assets consume significant amounts of energy for heating, ventilating, cooling, water heating, lighting, and using equipment and appliances. NEPI also considers the KPI to be one of the key topics for its operations based on its 2022 materiality assessment. One of its strategic pillars is dedicated to investments in sustainable buildings, which implies that it will take steps toward decarbonizing its portfolio, increasing energy efficiency, purchasing renewable energy, and reducing emissions.

KPI 2	Common areas energy intensity reduction	Not aligned	**Aligned**	Strong	Advanced

We assess NEPI's KPI 2 as aligned. Its objective, calculations, and scope methodology are clearly articulated in the framework. The KPI, aimed at energy intensity reduction (kWh /sqm), is particularly relevant for retail malls, for which energy consumption is high. The KPI covers the energy consumed in the company's standing assets common areas (all operational assets are considered) including gas, electricity, district heating, and cooling.

The KPI is calculated using energy consumption (kWh) in the common areas divided by the average annual common areas. To measure the consumption in the common areas, the group uses meter-reading data to ensure completeness and accuracy in the data collection platform. The company follows EPRA reporting guidelines for the normalization of the KPI, which allows for external benchmarking. Similar to KPI 1, we view positively that the KPI is expressed as a sustainability outcome rather than a financial proxy.

We view as adequate that the KPI covers energy intensity because energy use in buildings has been a major contributor to climate change (see "Key Sustainability Factors: Real Estate," published July 20, 2021). However, the KPI only covers energy intensity in common areas, which limits our assessment to aligned. This KPI also contributes to the first pillar of the group's sustainability strategy, namely "Invest in Healthy and Sustainable Buildings", which is focused on climate change mitigation and adaptation.

Calibration of sustainability performance targets (SPTs)

The Principles make optional recommendations for stronger structuring practices, which inform our ambition opinion as aligned, strong, or advanced. We consider the level of ambition for each target by assessing its clarity and characteristics, how the issuer defines the target with reference either to its past performance, or to external or competitor benchmarks, and how it explains what factors could influence future performance.

✔ NEPI Rockcastle's sustainability-linked financing framework is aligned with this component of the SLLP.

		Not aligned	Aligned	Strong	Advanced
SPT 1	Decrease scopes 1 and 2 greenhouse gas emissions intensity by 40% during 2024-2030, compared to the 2022 baseline		**Aligned**		

We believe the ambition, clarity, and characteristics of the issuer's SPT are in line with Principles' requirements. Specifically, the framework outlines the strategy to reach the target, providing relevant information on past and expected future performance. NEPI sets the baseline year (2022) and outlines the expected timeline for the target achievement (2024-2030) along with the annual target observation dates.

NEPI has selected 2022 as the baseline because it views this year as the first representative year of its operations, showing full recovery after the pandemic years. We note 2019 had the highest greenhouse gas emissions intensity of the years with available public information (2019 to 2022). NEPI also highlights that the pandemic affected 2020 and 2021 performance.

The company has benchmarked the SPT against four years of its historical performance (2019-2022). The historical pace was faster in 2019-2022 than that projected by 2030. However, we still view the target as ambitious because the company has a concrete emissions reduction strategy that will require significant investments and take longer to implement. Planned investments include improving the energy efficiency of assets though retrofits and new equipment and technology (for instance a LED program, building management system improvements, sensors, AI and smart meters, and improvements to heating, ventilation, and cooling systems) and increased renewable energy use (procuring electricity from renewable sources, based on certificates of origin, and rolling out a solar panels program). These measures, while reducing the pace of carbon reduction compared to previous years, should contribute to steadier, more sustainable reduction rates. The strategy for carbon reduction in 2019-2022 was largely focused on purchasing electricity from renewable sources, which we view as a less robust carbon reduction measure. The company clearly states in the framework that it is not planning to use carbon emissions offsets to achieve this target, which we view as a stronger characteristic.

NEPI has also prepared a dedicated benchmark of its target against its peers. The benchmark exercise covered the company's main peer group, with operations in Europe, the U.K., or across the world. After reviewing peers' targets, we believe SPT 1 is within range of peers' performance.

The company also seeks to align and set new science-based targets with the Science Based Targets initiative (SBTi), in line with the 1.5°C warming scenario.

Baseline	**Decrease energy intensity in common areas by 40% over 2024-2030, compared to the 2022 baseline**						
2022	**2024**	**2025**	**2026**	**2027**	**2028**	**2029**	**2030**
Of the baseline	5%	10%	15%	25%	25%	30%	40%

SPT 2 Decrease energy intensity in common areas by 30% during 2024-2030, compared to the 2022 baseline

Not aligned | **Aligned** | Strong | Advanced

We consider the ambition, clarity, and characteristics of the issuer's SPT to be in line with the Principles' requirements. Specifically, the framework outlines the strategy to reach the target, providing relevant information on past and expected future performance as well as annual observation dates. We note that the strategy defined in SPT 1 will also support the achievement of SPT 2 considering the direct link between energy intensity and scopes 1 and 2 emissions. NEPI outlines the baseline year (2022) and the expected timeline for the target achievement (2024-2030). The company has benchmarked the SPT against four years of its historical performance (2019-2022). It achieved a faster decrease in energy intensity in 2019-2022 than the pace it expects between now and 2030. However, we still view the target as ambitious because the company's strategy to decrease energy intensity will require significant investments and take some time to implement. It plans to increase its assets' energy efficiency through retrofits and by installing new equipment and implementing technologies, as well as by developing new assets that are highly energy efficient. NEPI has also provided a peer benchmark for its target. However, we do not believe the benchmark exercise allows a comprehensive comparison of targets across the peer group because only two peers have energy-related targets. This is not enough for us to draw a definitive conclusion about the ambition of the target.

The framework provides some information on the strategy and means by which NEPI will reach the target. Key initiatives include improvements in technologies and the implementation of new technologies, retrofits, and investment in highly efficient equipment.

Baseline	**Decrease energy intensity in common areas by 30% during 2024-2030, compared to the 2022 baseline**						
2022	**2024**	**2025**	**2026**	**2027**	**2028**	**2029**	**2030**
Of the baseline	5%	7%	10%	15%	20%	25%	30%

Instrument characteristics

The Principles require disclosure of the type of financial and/or structural impact involving trigger event(s), as well as the potential variation of the instrument's financial and/or structural characteristics.

✔ NEPI Rockcastle's sustainability-linked financing framework is aligned with this component of the SLLP.

NEPI commits to disclosing all structural characteristics of the instruments issued under the framework in the corresponding loan documentation. This documentation will include the KPIs, the SPTs, calculation methodologies, target observation dates, and trigger events of each financed instrument issued under the framework.

The framework states that trigger events may result in step-ups and/or step-downs in the margin of the financed Instruments. This may take place as a consequence of failing to meet performance targets by the target observation dates or failing to obtain annual external verification of the performance of the KPIs against the SPTs. The size of the margin adjustment will be specified in the relevant loan documentation. In addition, there may only be one step-up and/or step-down in the margin of any given instrument for the duration of its life.

In addition, in cases where instruments are issued with the same KPI as existing instruments, the SPT of the former must be of equal or greater ambition than the latter.

Reporting

The Principles make optional recommendations for stronger disclosure practices, which inform our disclosure opinion as aligned, strong, or advanced. We consider plans for updates on the sustainability performance of the issuer for general purpose funding, or the sustainability performance of the financed projects over the lifetime of any dedicated funding, including any commitments to post-issuance reporting.

✔ NEPI Rockcastle's sustainability-linked financing framework aligned with this component of the SLLP.

Disclosure score	Not aligned	Aligned	**Strong**	Advanced

We consider NEPI's overall reporting practices to be strong.

The company commits to disclose the performance of the KPIs and the SPTs for 2024–2030 or as long as no finance instruments are outstanding, as well as information on recalculation and the verification report on the KPIs. This information will be included in its Sustainability-Linked Financing Progress Report, which it will share with its relevant funding partners on an annual and private basis until there are no outstanding instruments. The report will be published no later than 180 days from the end of the calendar year.

We view positively that recalculations of the baseline, KPIs, SPTs, and their values will be included in the annual reporting and verified by an external reviewer. Moreover, the framework delineates the types of drivers that may cause such recalculations, namely corporate structure, or methodology or regulatory changes.

Post-issuance review

The Principles require post-issuance review commitments including the type of post-issuance third-party verification, periodicity and how this will be made available to key stakeholders. Our opinion describes whether the documentation is aligned or not aligned with these requirements. Please note, our second party opinion is not itself a post-issuance review.

✔ NEPI Rockcastle's sustainability-linked financing framework is aligned with this component of the SLLP.

NEPI commits to obtain independent and external post-issuance verification of the performance of the KPIs relative to the SPTs. This report will be included in its annual Sustainability-Linked Financing Progress Report. Failure to obtain external verification will automatically result in an adjustment in the instrument characteristics. The report will be shared on a private basis with the relevant funding parties.