APG Guidelines for Green, Social, and Sustainable Bonds

Introduction

Why does APG invest in green, social, and sustainable bonds?
For APG, responsible investing is a way to improve the investment portfolio's risk/return profile while contributing to a sustainable world for our clients and their participants. As a long-term investor, we are committed to growing our investments in solutions that contribute to the United Nations Sustainable Development Goals (SDGs), on behalf of our clients. Investing in green, social, and sustainable bonds (hereafter: green and social bonds) helps us achieve this.

How does APG decide which green and social bonds to buy?
APG first evaluates potential bond investments to ensure they meet our financial risk and return requirements as well as environmental, social, and governance (ESG) considerations. Subsequently, we use a sector-specific framework[1] to identify which investments contribute to the SDGs and are classified as Sustainable Development Investments (SDIs). In order to ensure that each investment lives up to our ESG quality and integrity standards, we address the key issues facing the market for green and social bonds. While we aim to increase our allocation to green and social bonds, we do so in a prudent manner.

Guidelines

As a leading, long-term responsible investor, APG advocates responsible, sustainable growth in the green and social bond market. We focus on quantity, quality and engagement.

1) Quantity: We grow our allocation to green and social bonds in a prudent manner.

Benefits of Investing in Green and Social Bonds

- Increasing our Exposure to Sustainable Development Investments – eligible green and social bonds represent an important channel for increasing our SDIs by providing a source of financing for issuers that want to engage in sustainable business projects.
- Market Awareness – continued growth in the green and social bond markets helps to raise awareness and educate market participants on sustainability topics. Greater awareness of investors' growing demand for green and social bonds could also encourage companies to develop sustainable business practices that require financing.
- Market Growth – as issuance spreads across sectors, companies launch green or social bond programs in order to keep up with their peers. Establishing formal green or social bond programs can also lead to improvement in ESG standards for issuing companies.

Green and Social Bonds vs. Regular Bonds
APG conducts financial and ESG analysis as the starting point for determining the soundness of all potential investments, including green and social bonds. Since green and social bonds are pari-

[1] APG designed the framework for Sustainable Development Investments (SDIs) in corporation with other Dutch investors.

passu with regular bonds, they are exposed to the same underlying credit risks. Accordingly, we evaluate potential green and social bond investment opportunities along the same relative value guidelines as other bonds and consider their overall portfolio fit.

As long as green and social bonds aren't issued at a premium to comparable bonds, we will continue to seek opportunities to grow this allocation. However, if these bonds are no longer attractive from a relative value standpoint, we may have to exit such investments~~.~~

Leverage APG's Reputation as a Long-Term, Responsible Investor
We continue to communicate our interest in expanding APG's allocation to green and social bonds as part of a firm-wide commitment to being a leading, long-term, responsible investor. We believe publishing statements in support of green and social bond issuance, communicating our targets, and outlining standards, can help corporate issuers better understand investor demand and encourage issuers to enter the market. Further, APG frequently acts as a sounding board for syndicate teams, corporate treasurers, and counterparty sales forces by providing feedback on their respective green bond programs.

Emerging Opportunities to Diversify our Portfolio
New types of green bond issuers are emerging, highlighted by growth in sovereign issuance and in green securitizations (i.e. Green MBS), which represent another potential avenue for growing our green bond allocation over time.

2) Quality: We ensure green and social bonds' sustainability profile meets our standards.

Issuer Sustainability
An important question is whether green and social bonds should be evaluated purely on a use-of-proceeds basis or in the context of the issuer's overall ESG profile. Second-party opinions and green assessments by rating agencies are deliberately project-specific and independent of the issuer's overall "greenness", leaving this determination up to investors.

We evaluate the ESG profile of green and social bond issuers as the first step in our due-diligence process to ensure issuance is part of a more comprehensive sustainability strategy. Our Inclusion Methodology allows us to make this assessment by identifying companies as 'ESG Leaders or Laggards' through a proprietary, industry-specific scoring model. A leader designation indicates that a company has demonstrated an awareness of the most relevant sustainability risks in its sector, has effective policies and procedures in place to address these issues, and has not been involved in any major controversies.

When a green/social bond issuer is considered a leader we are generally confident that the company's ESG profile meets our standards, but we still aim to gain a more thorough understanding of the issuer's overall sustainability policies and assess the use of proceeds in the context of the issuer's broader corporate strategy. After we've invested, we analyze the use of proceeds by mapping the impact to a corresponding SDG category and identify any potential negative externalities that might offset the positive impact. This assessment leads to a proprietary SDI-classification.

This approach does not preclude investing in green or social bonds from issuers determined to be laggards or considered controversial from a sustainability perspective, but a greater level of due diligence is required from an ESG perspective. Recognizing that many companies are still very early in their sustainability initiatives, we are careful not to discourage them from coming to the green/social bond market. At the same time, we strive to maintain the integrity of the market and hold companies accountable for their sustainability policies. We aim to make sure the company is improving from a sustainability perspective.

Under the Inclusion Policy we are able to invest in green or social bonds issued by ESG laggards as long as we properly explain the rationale and expect improvement through engagement. If the use of proceeds can be linked to a positive SDG contribution and there is demonstrated progress and commitment at the firm-level to improving ESG practices, we will consider this in our review.

Reporting Requirements

APG expects issuers to report on the use of proceeds. In addition, we encourage them to report on the environmental and social impact of the bond. If reporting standards according to the Green Bond Principles (GBP) are not met, we seek to understand the reasons why and determine whether this undermines the “green integrity” – a comply or explain approach.

The GBP encourage a second party opinion. Second party opinions facilitate easier evaluation of green/social credentials and guard against “greenwashing”, but there are instances where for instance the impact of an issuer’s project is directly measurable and very clearly green. Following investment, we also conduct our own analysis to understand how the designated use of proceeds creates a positive SDG impact and attempt to link this back to the issuers’ overall sustainability profile. While a second opinion is currently not a hard requirement for investment for us, we consider it very valuable and an evolving market practice.

Green Labeling

Companies issuing green and social bonds signal to investors that they are proactively addressing long-term sustainability risks and opportunities. This can be a good proxy for management quality, identifying forward-thinking, long-term focused management teams.

APG encourages clearly defined labels and terminology in line with GBP guidelines or the proposed EU Green Bond Standard. When an issuer applies the green or social label to a bond without conforming to the GBP we again use a “comply or explain” approach and examine any potential discrepancies to ensure our key requirements are met. While use of the “green/social” label in accordance with the GBP promotes transparency and standardization, our ESG-integrated investment approach allows us to identify SDI opportunities that may be overlooked by other investors because they are not explicitly labeled as green or social bonds.

Although we prefer the use of existing bond labels, we recognize issuers may rely on alternative labels, such as SDG Bonds or Transition Bonds, to promote their sustainability activities. We follow the same guidelines when evaluating these types of bonds. We also have a preference for green/social bonds that are closely linked to capex with clear direct impact on the Sustainable Development Goals.

3) Engagement: We show leadership in promoting the market for green and social bonds.

Supply vs. Demand
Investor demand for corporate green and social bonds continues to be high, but the US market remains constrained by limited supply compared to Europe, where the market for green and social bonds is more developed. We believe raising awareness around the high level of demand for these securities, and clearly communicating what our standards are, can encourage market participants to promote greater issuance. Increased diversity of green and social bonds could also spur demand by appealing to more investor types and allowing for better portfolio diversification, thus creating a virtuous circle that contributes to overall market growth. However, our efforts to grow the green and social bond market should not compromise our expectations with respect to "greenness" of the bonds.

Engagement Efforts
APG is a member of the Climate Bond Initiative and is a key contributor to several industry initiatives aimed at expanding the size, scope, and transparency of the green and social bond market. We encourage issuers to establish recurring green/social bond programs when we engage with them directly. We've provided feedback to rating agencies on their green bond assessment methodologies and we regularly contribute to broader efforts around ESG integration in fixed income. Notably, APG has actively contributed to the proposed EU Green Bond Standard.

Our discussions with corporate issuers also aim to connect green/social bond issuance to a broader ESG dialogue by making companies aware of how we are using their sustainability reporting, as well as external ESG ratings, as part of our ESG integration process. We increasingly highlight that green bond issuance can be a barometer for issuers' overall ESG commitment and risk/governance processes. These efforts are designed to help reduce issuers' perceived risk about how investors will respond to a potential green bond program.

In addition to interacting with issuers, we actively engage with investment banks and syndicate teams to understand the role they can play in encouraging companies to issue green and social bonds. These efforts have helped us better identify the obstacles to greater issuance and uncover ways to more effectively signal investor demand.