

Environmental and Sustainability Guidelines

Adopted by the Managing Director of the Nordic Environment Finance Corporation on 2 May 2022 with entry into force as of 2 May 2022.

NEFCO

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Responsible Function/Department

Environment and Sustainability

Document version history and review dates

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These Guidelines shall be reviewed at least every three (3) years.

1. Introduction

Our task is to accelerate the green transition by financing Nordic green solutions that have the potential to be scaled up on global markets. In other words, we can only offer funding to activities that generate environmental benefits.

In our experience, high sustainability standards are prerequisites for continuous positive returns and long-term business success. Our sustainability commitments, principles and obligations for financing activities are outlined in the Nefco Environmental and Sustainability Policy.

We are committed to ensuring that the activities in which we invest generate positive environmental impacts, while reducing sustainability risks and mitigating adverse impacts. This may include a reduction in greenhouse gas emissions and the load of nutrients, projects involving sustainable consumption or production, increasing resource efficiency and closing material loops.

2. Objective and scope

The objective of Nefco's sustainability assessment procedures is to ensure that the projects we finance generate positive environmental impacts and are aligned with the principles, commitments and obligations outlined in our Environmental and Sustainability Policy. Furthermore, these Guidelines describe how we identify and prioritise the projects to which our funding can add most environmental value.

In these Guidelines, we describe how we assess the sustainability aspects of Nefco's financing activities as required by Nefco's own capital (so-called Investment Fund). This sustainability assessment covers not only the activity financed but also how sustainability is embedded throughout the client's organisation. Our involvement with the client aims, through dialogue, to elevate and increase understanding of sustainability aspects in the client's organisation and to support effective implementation and management of green projects.

Over its 30-year journey, Nefco has developed its own procedures for environmental and social assessment, project management and monitoring as well as financial and integrity due diligence. All these elements are integrated into the investment process.

Our aim is to ensure:

- that the project generates substantial positive environmental impacts and contributes to and accelerates the green transition,
- that possible environmental and other sustainability risks are sufficiently well considered and appropriately mitigated, and
- that clients work strategically and formally to anchor sustainability in the business plan and daily operations.

Please note that these Guidelines only cover the procedures for environmental and social due diligence throughout the project lifetime. The financial and integrity due diligence, which is integrated in the investment process and carried out in parallel to the environmental assessment, is not covered by this document.

3. Sustainability assessment procedure

These procedures are used to assess the environmental and sustainability impacts of projects considered for financing from Nefco’s Investment Fund. In addition to our own capital, we manage several trust funds that are governed by a separate agreement with the donor, which may set out specific environmental priorities and purposes. In principle, the same methodology is used when applicable.

Nefco’s Environment and Sustainability Department is responsible for the sustainability assessment throughout the project life cycle. The assessment is performed in close collaboration with the project team. The following chart illustrates the sustainability assessment process for a typical project financed via Nefco’s own capital throughout the project life cycle, i.e., from project proposal to implementation and monitoring stage.

Sustainability Assessment Procedure	1 Initial Screening		2 Sustainability Assessment		3 Sustainability Monitoring	
					3.1 Annual Monitoring	3.2 Final Monitoring
Client/Applicant to provide	<ul style="list-style-type: none"> Project proposal form or freely composed format 		<ul style="list-style-type: none"> Environmental, Social and Governance (ESG) questionnaire Environmental Impact Assessment (EIA; if applicable) Relevant permits and licences Environmental and Social Action Plan (ESAP; when necessary) 		<ul style="list-style-type: none"> Annual impact and sustainability reporting 	<ul style="list-style-type: none"> Final monitoring information
Nefco reviews	<ul style="list-style-type: none"> Environmental benefits of the project and ensuring that the project’s activities are not listed in our Exclusion List 		<ul style="list-style-type: none"> Contribution to the environmental drivers (EU Taxonomy) Direct or indirect positive environmental and sustainability impacts Potential environmental and social risks Technology scale-up potential Benchmarking sustainability performance 		<ul style="list-style-type: none"> Progress of the projects against the expected improvements Progress related to the Environment and Social Action Plan (ESAP; if applicable) 	<ul style="list-style-type: none"> Result related to the expected impacts Lessons learned during project implementation Status related to the Environment and Social Action Plan (ESAP; if applicable)
Nefco tools and frameworks	<ul style="list-style-type: none"> Exclusion List from NEFCO’s Environmental and Sustainability Policy Technological Readiness Level 		<ul style="list-style-type: none"> EU Taxonomy NEFCO-specific criteria Sectoral handbooks Environmental solutions tool Environmental cost-efficiency Sexual exploitation, abuse and harassment (SEAH) 		<ul style="list-style-type: none"> United Nations Sustainable Development Goals (UN SDGs) NEFCO impact and project indicators 	
Continuous dialogue and feedback between NEFCO and client						

3.1. Initial screening

The sustainability assessment process starts when a potential client presents a project proposal to Nefco.

What we expect from the client

The following information shall be provided to Nefco:



Basic company information and maturity of its technology/solution



Detailed project description including preliminary budget



Qualitative and quantitative description of potential positive environmental impacts



Presentation of potential sustainability risks

There are two ways in which a project proposal can be presented to us:

- a) Nefco's project proposal form, available on the Nefco website (primarily for private sector projects)
- b) In a freely composed format

Nefco reviews

Upon receipt of a sufficient project proposal, Nefco performs an initial sustainability screening. The main focus is on the environmental benefits of the project and on ensuring that the project activities are not listed in our Exclusion List, as defined in the Environmental and Sustainability Policy.

If deemed to be in line with Nefco's mandate and provided it meets the other related criteria, the project is accepted into our investment pipeline for an in-depth sustainability assessment.

3.2. Sustainability assessment

Once a project has passed the initial screening and been accepted into the investment pipeline, an environmental and sustainability assessment is conducted. Nefco's sustainability assessment includes a dialogue with the client and usually a site/client visit.

The aim is to:

- Identify to which environmental driver (EU Taxonomy objective) the project contributes
- Ensure that projects to be financed have a direct or indirect (quantifiable) positive environmental and sustainability impact
- Identify and assess potential environmental and social risks
- Assess technology demonstration and scale-up potential
- Assess the project and the client against industry best practices (benchmarking) and the necessary green transition

What is taken into account?

Below, we outline the topics (see sections a-e below) that we use in the assessment process. This includes the EU Taxonomy for Sustainable Investments and Nefco's own specific criteria that we have developed during the course of our operations.

a) Environmental driver

In identifying the environmental benefits of a project, Nefco uses the six environmental objectives established by the EU Taxonomy framework.

For economic activities that are not yet covered by the EU Taxonomy, Nefco uses its own definitions within the spirit and logic of the taxonomy.

Nefco engages and cooperates with its new and existing clients to identify taxonomy-eligible¹ economic activities and how these activities could accommodate the eligibility criteria. Secondly, Nefco aims to analyse if the financed projects are taxonomy aligned². However, since the taxonomies are still under development, it is understandable that SMEs might need some time to get their (eligible) activities fully taxonomy aligned. Nevertheless, Nefco encourages its clients to adapt and measure taxonomy-relevant information early, as they may gain a competitive advantage and preparedness for future compliance requirements.



¹ Taxonomy eligibility implies that an economic activity must contribute substantially to at least one of the six environmental objectives and is included in the EU Taxonomy regulation.

² Taxonomy alignment implies that an activity is compliant with the technical screening criteria, the 'do no significant harm' criteria and the minimal safeguards linked to the activity.

b) Assessment of environmental impact

Nefco considers both direct and indirect impacts of the projects. The assessment is normally conducted on a sectoral basis (e.g., wastewater treatment, industry, transportation, renewable energy, waste, agriculture). In principle, however, the method is the same for all project proposals.

Most commonly, the situation prior to the implementation of a project (often referred to as 'baseline') is used as the starting point for assessment. The expected quantitative reductions and improvements are calculated during the business planning stage.

In certain cases, the environmental impact can be indirect and qualitative. Some projects and associated activities may not directly generate environmental impact through their own performance, but they can play a crucial role, e.g., in the decarbonisation of the economy by enabling other activities to become low carbon.

When applicable, we assess the project's environmental cost-efficiency. The project may provide environmental benefits, but the amount may be too small compared to the investment amount to be eligible for Nefco financing. These assessments are conducted on a case-by-case basis when relevant.

c) Environmental and social risks

Nefco applies risk-reduction measures in its operations. All projects should be carefully designed and implemented so that potential environmental and social risks are sufficiently mitigated.

In certain cases, clients are requested to prepare an Environmental and Social Action Plan (ESAP). The purpose of an action plan is to mitigate significant sustainability risks to an acceptable level and improve clients' sustainability practices. The measures to be implemented and the time frame for each will depend on the specific issues identified and their characteristics. Nefco will support the client in preparing the action plan. The action plan must be approved by Nefco and forms part of the financing agreement.

The client must demonstrate that applicable permits and licences relating to environmental and/or social aspects are in place for the project. In case of pending permits, a satisfactory plan for obtaining permits needs to be demonstrated.

d) Technology scale-up potential

In addition to the environmental and social risks, Nefco assesses the technologies and solutions to be financed. In order to compete with other existing technologies, an emerging technology must improve the profitability and efficiency of the activity. When assessing the demonstration value and scale-up potential, Nefco uses its own sectoral and industry expertise, and in cases in which a feasibility study is available, Nefco reflects on its findings.

Nefco generally finances technologies that are technically proven and commercialised. In this assessment, Nefco employs the widely used method called the Technology Readiness Level³, most commonly levels 8 or above - *system complete, qualified and small-scale commercial trials completed* - are accepted for Nefco financing.

e) Benchmarking

³ More information is available at: https://ec.europa.eu/research/participants/data/ref/h2020/wp/2014_2015/annexes/h2020-wp1415-annex-g-trl_en.pdf

Nefco aims to evaluate how well the project aligns with industry best practices. Nefco has developed sectoral handbooks for its internal reference. There are handbooks for Biomass for Energy, Biogas, Solar Power and Heat, Wind Power, and Building Sector Energy Efficiency. These handbooks explain the sectoral best practices and additionally guide the sustainability assessment.

In addition to the Nefco-specific handbooks, other relevant project benchmarks can consist of sector- and industry-specific voluntary or regulatory standards, including, for example, industry best practices guidelines, EU Taxonomy criteria, EU Emission Trading System (ETS) benchmarks and EU Best Available Techniques (BAT) reference documents. Special emphasis is given to research and scientific reports.

Tools used during the assessment

To complement the frameworks and handbooks above, and to assess the impacts and determine to what extent the project and the client meet the sustainability requirements, we use various tools in our assessment process. We use our own tool 'Environmental solutions by sectors' to identify potential green technologies. In addition, Nefco has developed a risk tool for assessing sexual exploitation, abuse and harassment (SEAH) in projects. The tool is country and sector based and gives an indication of the potential SEAH risks.

What we expect from the client

Our clients are requested to fill in a self-assessment Environmental, Social and Governance (ESG) questionnaire. This questionnaire will help Nefco to get a better understanding of how the client understands and works with ESG factors in its business operations and supply chain, and how these will be applied in the project seeking funding. The questionnaire combined with client dialogue and site visits also helps to identify the need for an Environmental and Sustainability Action Plan (ESAP) and raises our client's awareness of sustainability issues.

The following sustainability-related information should be provided to Nefco:



- ✓ Environmental, Social and Governance (ESG) questionnaire
- ✓ Environmental Impact Assessment (EIA; if applicable)
- ✓ Relevant permits and licences
- ✓ Environmental and Social Action Plan (ESAP; in cooperation with Nefco, when deemed necessary)

3.3. Sustainability monitoring

We encourage our clients to disclose non-financial information annually, and we cooperate with them to enhance their sustainability practices and capacities. Transparent and accurate non-financial sustainability disclosure is expected to become compulsory even for small and medium-sized companies, and fore-runner companies are expected to gain advantage. Nefco is committed to report annually on its financing impact. Nefco's results of the sustainability monitoring are presented in our annual reporting.

What we expect from the client

Clients shall report to Nefco on the impacts of the financed project on a yearly basis. Clients are also expected to co-operate with Nefco when the loan has been fully repaid or exit has taken place.

The following information should be provided to Nefco:



- ✓ Annual impact and sustainability reporting
- ✓ Final monitoring information

Nefco reviews

Annual and final monitoring allow us to track the operational performance of the projects as well as gather lessons learned together with clients.

a) Annual monitoring

Based on defined Nefco impact indicators appropriate for the project, the client shall monitor and report on an annual basis. In the case that the project has been requested to prepare an Environment and Social Action Plan (ESAP), it shall also report annually to Nefco on the progress of the planned and agreed actions. In the event that the actual impact or improvement is significantly less than expected, Nefco can require an evaluation to understand the underlying reasons.

Besides the agreed project-specific impact indicators, all projects are required to report some core indicators depending on the project and its sector. The following table represents some of the Nefco's core indicators and their contribution to the United Nations Sustainable Development Goals.



Nefco's core indicators

6 CLEAN WATER AND SANITATION



- Amount of wastewater treated (m³/a)
- Reduced phosphorous discharges (t/a)
- Reduced nitrogen discharges (t/a)

7 AFFORDABLE AND CLEAN ENERGY



- Energy efficiency:
- Saved heat and electricity (MWh/a)
- Renewable energy:
- Added capacity (MW)
 - Added generation (MWh/a)
 - Avoided CO₂e (t/a)
 - Number of beneficiaries

9 INDUSTRY, INNOVATION AND INFRASTRUCTURE



- Number of jobs created

13 CLIMATE ACTION



- Avoided CO₂e (t/a)

14 LIFE BELOW WATER



- Reduced phosphorous discharges (t/a)
- Reduced nitrogen discharges (t/a)



Project-specific indicators

Some examples:

- Avoided NO_x (t/a)
- Avoided SO_x (t/a)
- Particulate matter (PM) (t/a)
- Amount of waste reduced (t/a)
- Amount of waste treated (t/a)

Nefco or an accredited external consultant may review the reported figures to make sure that the data is reliable and accurate enough. When necessary, we can visit the project site.

In case of non-compliance, the client will be requested to take corrective action within a set time frame. The consequences in cases of non-compliance may include, as relevant, suspending disbursement, immediate repayment and/or notifying the proper authorities and co-financiers.

b) Final monitoring

The final monitoring takes place three years after project implementation or when the project has been fully repaid. Nefco will conduct the final monitoring.

The aim is to understand to what extent the long-term environmental impacts/results were or were not achieved and identify useful lessons to be learned. We pay attention to key environmental and sustainability issues identified during the Sustainability Assessment being included in the evaluation. Nefco may require access to the site and all project documentation relating to the environmental and sustainability performance.