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Second Party Opinion

Nordkraft Green Finance Framework

May 3, 2024

Location: Norway

Sector: Power Utility

Primary contact

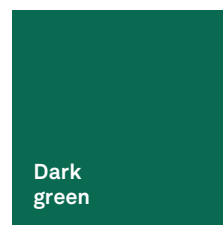
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Alignment With Principles

Aligned = ✓ Conceptually aligned = ○ Not aligned = ✗

- ✓ Green Bond Principles, ICMA, 2021 (with June 2022 Appendix 1)
- ✓ Green Loan Principles, LMA/LSTA/APLMA, 2023

See [Alignment Assessment](#) for more detail.



Dark green

Activities that correspond to the long-term vision of a low-carbon climate resilient future.

Our [Shades of Green Analytical Approach](#) >

Strengths

Eligible projects will support Norway's climate targets. There is a need for additional renewable generation capacity and the expansion and strengthening of power grids to support electrification across sectors in Norway.

The eligible project category includes climate-adaptation measures, which we view positively. Given the risks of river flooding and higher levels of precipitation in Norway, we see as a strength that eligible projects include the fortification of hydropower facilities and dams.

Nordkraft will address SF6 gas within its procurement process, which is a challenge in the distribution grids. The company procured SF6 free equipment for a recent project, though it has said that technical restrictions mean this is not always possible. Alternative market solutions to SF6 are expected ahead of the EU Regulation that prohibits SF6 in new switchgears up to 24 kilovolts (kV) from 2026 and 145 kV from 2032.

Weaknesses

No weaknesses to report.

Areas to watch

The company has not yet set emission reduction targets. Although Nordkraft is a pure play renewable company and has a target to increase its renewable energy production capacity, there are direct and indirect emissions--such as emissions associated with the construction of hydropower reservoirs and electricity masts--associated with its operations. Nordkraft has initiatives, although no formal strategy, to reduce these emissions. It is also required by Norwegian regulation to include environmental matters in procurement.

Proceeds could fund equity investments in pure players, including minority stakes, which could limit the issuer's ability to control activities and environmental benefits of investments. However, Nordkraft commits to exclude these projects from the Green Projects portfolio should invested companies cease to derive 90% of their revenue from eligible project activities. Nordkraft will endeavor to replace it with another Green project.

Eligible Green Projects Assessment Summary

Eligible projects under issuer's green finance framework are assessed based on their environmental benefits and risks, using Shades of Green methodology.

Renewable Energy

 **Dark green**

Investments and expenditure related to development, construction, installation, operation, improvement, repair and maintenance of facilities connected to the generation of electricity from hydropower projects.

Investments and expenditure related to development, construction, installation, operation, improvement, repair and maintenance of power distribution networks.

See [Analysis Of Eligible Projects](#) for more detail.

Issuer Sustainability Context

This section provides an analysis of the issuer's sustainability management and the embeddedness of the financing framework within its overall strategy.

Company Description

Nordkraft is a Norwegian power generation, transmission, and distribution company primarily owned by Norwegian municipalities, with approximately one-fifth of ownership held by Swedish municipalities. Since 1910, the issuer, headquartered in Narvik, Norway, has been dedicated to the development, production, and distribution of renewable energy, specifically hydro and wind power. Its main market area encompasses the northern Halogaland region of Norway, including Vesteralen, Ofoten, and Sor-Troms. Nordkraft serves about 52,000 customers through its power distribution network.

Material Sustainability Factors

Climate Transition Risk

Power generation is the largest direct source of greenhouse gas emissions globally, making this sector highly susceptible to the growing public, political, legal, and regulatory pressure to accelerate climate goals. Public awareness of the urgency for climate action has reached new highs. As a result, policymakers and regulators are more often pushing for faster transition to lower-carbon energy, especially as these technologies mature and become more cost-competitive. Over the past decade, we have seen multibillion-dollar impairments for most polluting assets, reflecting their weaker economics as taxes increase and they are displaced by new, cleaner technologies. In addition, more stringent decarbonization rules can lead to license restrictions.

Climate transition risks are highly material to stakeholders but tend to have more bearing on electricity networks, given their critical role in the energy delivery value chain and their direct exposure to upstream generators, which are a leading cause of greenhouse gas emissions. The number of countries announcing pledges to achieve net zero emissions continues to grow. With no direct emissions, renewable energy technologies have a vital role to play in reducing emissions associated with power and heat, which will be vital for limiting the global temperature rise to 1.5C.

Physical Climate Risk

Given fixed assets, generators are relatively more exposed to physical climate risks than other sectors. For stakeholders, extreme weather events, including wildfires, hurricanes, and storms, are becoming more frequent and severe and can result in power outages for large populations of users. As water is often a significant resource for hydro, nuclear and fossil-fuel based power plants, exposure to flooding, drought, or warmer temperatures can also negatively affect operations. In turn, these dynamics, coupled with regulatory pressure to preserve security of supply, are leading players to enhance asset resilience. Physical climate risks generally involve significant financial losses for operators due to repairs and, more importantly, from exposure to extreme power price spikes or business disruption. We expect these dynamics to continue but vary by region depending on regulatory responses.

Transmission and distribution networks operate fixed assets that span large service territories, making them highly exposed to physical climate risks. These events can cause network service disruptions for large populations, elevating stakeholder materiality. Key risks in Norway include increase in annual mean temperature and precipitation, rainfall floods, summer droughts, sea level rise, and ocean acidification.

Biodiversity and Resource Use

Renewable power, which is increasing to meet climate goals, requires large land areas that may be in sensitive habitats and can alter ecosystems, affect species, and compete with other valuable land uses such as agriculture. In most jurisdictions, local regulations require that renewable projects are accompanied by environmental impact assessments to identify biodiversity risks

and harm mitigation measures. This is especially pertinent for hydropower plants, which, if not properly managed, can pose biodiversity risks such as habitat disruption, modified water flows, and hindrances to fish migration.

Alongside climate risk, the loss of biodiversity is one of the big global challenges. The development of transmission and distribution lines can affect biodiversity, including through habitat fragmentation, disturbance to wildlife, and the risk of contact with power lines. Building and maintaining these lines can also involve clearing vegetation, which could further impair local ecosystems.

Impact on Communities

Community impacts are more acute for stakeholders given how close networks are to where people live and work, and because energy and water services are essential for community health and well-being. Stakeholder impact arises from the construction and location of lines, especially in areas new to industrial development and in Indigenous territories. Line development is accelerating to meet climate goals, and local governments can grant eminent domain. Moreover, service disruptions and fires pose severe, and sometimes irreversible, community health and safety hazards.

The need for renewable power development related to climate goals intensifies the materiality for stakeholders. Sites with high renewable potential are often in or near communities, which can prompt strong local opposition.

Access and Affordability

The affordability and reliability of networks are under pressure from climate-related risks, exacerbating effects for stakeholders. Energy is essential in supporting human health and well-being, as well as global economic development. Service disruptions or steep price increases are likely to be amplified by the energy transition and physical climate risks. These dynamics can affect households' purchasing power and the competitive strengths of local industries, which make this highly important to stakeholders.

Issuer And Context Analysis

The framework's project categories aim to address Nordkraft's most material sustainability factors. Investment in renewable energy plays a central role in decreasing reliance on fossil fuels and addressing climate transition risk. Also, biodiversity factors are relevant for hydropower plants and power transmission and distribution networks, which the issuer factors into the planning phase of projects in collaboration with local authorities. We also think physical climate risks and impact on communities are important for the renewable energy project category in the framework, and the issuer's processes will play a key role in mitigating these risks.

The project focuses on expanding clean energy and distribution networks, which are part of Nordkraft's strategy. The company will invest Norwegian krone (NOK) 3.5 billion-NOK5 billion towards 2030's strategic targets for grid investments and expansion of green power generation projects, which include 1 terawatt-hour (TWh) of new renewable energy, an increase in overall output to 4 TWh from 2 TWh in energy operations (owned and third-party), and a 1,000 megawatt facilitation of new consumption. Its growth strategy includes supporting the establishment of green industries in Northern Norway. Although it started reporting emissions in 2022, the issuer has no immediate plans to establish targets. However, it has said it intends to focus on reducing carbon emission intensity. Embodied emissions, which accounts for almost all overall emission (95.9% of total emissions in 2022), mainly come from building hydropower plants and laying the foundation for power distribution masts (poles), as both activities require the use of concrete. Additionally, these masts carry significant embodied emissions from steel production. The issuer requires their partners and suppliers to adopt Nordkraft's environmental standards. Nordkraft's subsidiary Noranett gives environmental factors a minimum weight of 30% in procurement decisions. The issuer uses SF6 gas in its existing infrastructure but has implemented standards for its procurement and expects market solutions for the upcoming EU regulation. The company is also gradually switching its vehicles from combustion engines to electric and installing charging stations in its power plants.

The issuer's physical climate risk assessment focuses on hydropower and wind facilities, as well as areas such as transmission and distribution facilities. Extreme weather events, such as storms, floods, landslides, and rising temperatures, can damage power generation infrastructure and disrupt supply chains. Projects undergo impact assessments during the licensing process to address these risks. During the planning and design phase of power stations, the company accounts for the increased climate risk, specifically flooding and higher levels of precipitation. Nordkraft has disaster management plans to respond to and recover from physical risks. The plan includes emergency procedures, key personnel's roles and responsibilities, communication protocols for timely updates and coordination, and measures to minimize disruptions to operations.

Nordkraft aims to balance production and consumption and Noranett aims to operate cost-efficiently to contribute to achieve stable prices. The Norwegian power grid is regulated by the state, and prices are based on grid conditions. Nordkraft's income traditionally comes from produced electricity (which is more volatile) and grid fees (which are more stable). While expecting more volatile prices, the company works to efficiently increase its production of renewable electricity and attract green industries to increase total consumption and maximize production value. For example, the issuer established Nordkraft Industrinett as a separate grid company outside the regulated monopoly. This allows the industry to bear the cost of expensive installations, preventing a negative impact on end-consumers' grid fees. The Noranett grid's reliability level is 99.7%-99.9%.

Construction of renewable energy projects introduces biodiversity and land use risks. The Norwegian Water Resources and Energy Directorate requires small power plant developers to conduct surveys of biological diversity. The template outlines requirements for mapping nature types, species, and inspection routes. Nordkraft's initiative to address potential adverse environmental effects related to distribution assets includes rerouting grid projects away from protected areas, minimizing damage to vulnerable ecosystems, and consulting with local governments for comprehensive consideration of all aspects. However, the issuer has no specific biodiversity targets, because it primarily follows statutory regulation.

Nordkraft aims to engage in effective dialogue with local stakeholders for all projects in development. The issuer operates in the north of Norway, parts of which are covered by reindeer grazing rights given to the indigenous Sami people. Nordkraft engages with the local municipality, relevant landowners, and other stakeholders while developing projects, as required by regulation. Also, the issuer hosts information meetings that are open to local communities when relevant and necessary.

Alignment Assessment

This section provides an analysis of the framework's alignment to Green Bond and Loan principles.

Alignment With Principles

Aligned = ✓ Conceptually aligned = ○ Not aligned = ✗

✓ Green Bond Principles, ICMA, 2021 (with June 2022 Appendix 1)

✓ Green Loan Principles, LMA/LSTA/APLMA, 2023

✓ Use of proceeds

Nordkraft commits to allocate net proceeds issued under the framework to finance the acquisition and development of new eligible projects, and refinance existing eligible green projects. The issuer can allocate proceeds to investments in shares of pure-play companies that generate at least 90% of revenue from green project activities, including minority stakes. When an investment no longer meets the 90% threshold, it will no longer be considered a green project and will be removed from the green project portfolio. Nordkraft will endeavor to replace it with another green project. The maximum lookback period for operating expenditure is three years from the time of issuance.

The framework includes projects related to hydropower electricity generation and the power distribution network under one eligible green project category--renewable energy--in which Nordkraft aims to contribute to climate change mitigation and adaptation. The entire green bond framework project category is shaded in green; see the Analysis of Eligible Projects section for more information on our view of the expected use of proceeds' environmental benefits.

✓ Process for project evaluation and selection

The green finance committee at Nordkraft is responsible for determining the eligibility of green projects based on the framework's criteria. The committee consists of members from the management, operations, finance, and sustainability teams. Other internal representatives with specific expertise can be invited. All decisions will be made in consensus. Nordkraft follows a formal process to approve large investments, which requires both economical and risk-based assessments, including environmental and social risks. Only assets and projects that comply with the green project criteria of the framework, and which the green finance committee deems acceptable from an overall ESG risk perspective, are selected. The committee also can exclude green projects previously funded with green bonds.

The issuer has also included the exclusion list for green finance, namely linked to fossil-fuel-based energy generation, research or development within weapons and defense, and potentially environmentally negative resource extraction, gambling, or tobacco.

✓ Management of proceeds

The issuer commits to tracking net proceeds by earmarking an amount equal to the net proceeds from issued green finance instruments for financing and refinancing of green projects. Nordkraft's treasury is committed to ensuring that the value of green projects always exceeds the amount of green finance instruments outstanding. Net proceeds from instruments awaiting allocation will be held as cash or in short-term money-market funds for which, if possible, the exclusions list will also apply to temporary financing. If a funded green project no longer meets eligibility criteria, another qualifying project will replace it.

✓ Reporting

Nordkraft commits to reporting on the allocation of the net proceeds and the expected impact of the green eligible assets in its Allocation and Impact Report on its website, annually until full allocation. The report will include information on the amounts invested in each green project category defined in this framework and the share of new financing versus refinancing, the share of capital expenditure versus operating expenditure, and examples of funded green projects. It will also feature examples of

funded projects, the nominal amount of green finance instruments outstanding, and the amount of net proceeds yet to be allocated. We view positively that the issuer will align its impact reporting with the International Capital Market Association's Harmonised Framework for Impact Reporting.

Analysis Of Eligible Projects

This section provides details of our analysis of eligible projects, based on their environmental benefits and risks, using the Shades of Green methodology.

In the three years following issuance, Nordkraft expects to allocate 80% of proceeds to investments and expenditure related to power distribution networks, and the remaining 20% to hydropower projects.

The issuer expects to allocate 20% of proceeds to refinancing projects, and 80% to finance new projects for the first green bond issuance.

Overall Shades of Green assessment

Based on the project category shades of green detailed below, and consideration of environmental ambitions reflected in Nordkraft Green Finance Framework, we assess the framework as dark green.

Green project categories

Renewable energy

Assessment

 Dark green

Description

Investments and expenditure related to development, construction, installation, operation, improvement, repair, and maintenance of facilities connected to the generation of electricity from:

- Hydropower projects, including fortification of hydropower facilities and dams to ensure the ability to withstand higher levels of precipitation and improve the ability to prevent river flooding. Hydropower is subject to a power density above 5 watts per meter squared (W/m²), or life-cycle emissions below 100 grams of carbon dioxide equivalent per kilowatt-hour, or run-of-river plants without artificial reservoirs.

Investments and expenditure related to development, construction, installation, operation, improvement, repair, and maintenance of power distribution networks. The system is connected to the Norwegian and European power distribution systems.

Analytical considerations

- Hydropower and power distribution networks projects will support Norway's climate targets. According to the International Energy Agency, more electrification will be needed across sectors to meet Norwegian climate targets, which will require additional renewable generation capacity, as well as the expansion and strengthening of power grids to accommodate expanding demand for electricity.
- Most proceeds (80%) will fund investment and expenditure for power distribution networks. We view these projects as Dark green due to the importance of electrification to meet Norway's climate targets, supported by the low grid emissions factor in Norway and Sweden and eligible proceeds not financing connections to fossil-fuel assets such as offshore oil installations.
- The remaining 20% of proceeds will finance hydropower projects. We consider these Dark green as well because eligible projects will follow the EU taxonomy's substantial contribution technical screening criteria for the climate mitigation objective. The issuer

**Dark
green**

Activities that correspond to the long-term vision of a low-carbon climate resilient future.













Our [Shades of Green Analytical Approach](#) >

Second Party Opinion: Nordkraft Green Finance Framework

stated that the first issuance will finance one hydropower project that follows the power density criteria above 5W/m². We also considered the issuer's commitments to managing biodiversity and physical climate risks in the Dark green shading.

- Most infrastructure for Nordkraft's distribution grid subsidiary, Noranett, contains insulator gas uses SF6 gas, a highly emitting potent electrical insulator, as it was the industry standard at the time of the installation. The issuer informed us, however, that SF6-free solutions will be the standard in Noranett's procurement process, although not for 22 kV projects due to technical restrictions, as the company is starting to upgrade its infrastructure. The issuer expects current restrictions to be addressed with market solutions ahead of the new EU regulation that prohibits the manufacturing of switchgears requiring SF6 for voltages up to 24 kV starting from 2026.
- Environmental risks, including climate physical risks such as flood and landslide, and biodiversity and ecosystem impacts are evaluated in the planning phase, which had led the issuer to change the location of planned transformer stations or grid. Noranett also aims to avoid projects in areas with wetlands, moors, and sloughs. The issuer informed us that if this cannot be avoided, it engages with municipalities, counties, and the regulator to evaluate the impact and find appropriate solutions.
- For hydropower projects, the issuer is working to reduce the amount of concrete needed for to reinforce hydropower plants, and consequently reduce embodied emissions. It accomplishes this through a partnership with a research team that helped develop tools to combat the load and reduce concrete used.
- Reports from external experts are typically prepared to identify and mitigate environmental risks. All applications for the construction of power plants must contain a survey of biological diversity to comply with the national Biological Diversity Act.
- Hydropower facilities in Norway are exposed to physical climate risks, such as frequent floods and higher water inflows. During the planning and design phase of new power stations, the issuer takes into account the increased climate risk, specifically flooding and higher levels of precipitation. These considerations lead to adjustments to ensure new projects are resilient enough to withstand the potential impacts of climate change. We view as a strength that eligible projects include the fortification of hydropower facilities and dams.

S&P Global Ratings' Shades of Green

Assessments					
 Dark green	 Medium green	 Light green	 Yellow	 Orange	 Red
Description					
Activities that correspond to the long-term vision of an LCCR future.	Activities that represent significant steps toward an LCCR future but will require further improvements to be long-term LCCR solutions.	Activities representing transition steps in the near-term that avoid emissions lock-in but do not represent long-term LCCR solutions.	Activities that do not have a material impact on the transition to an LCCR future, or, Activities that have some potential inconsistency with the transition to an LCCR future, albeit tempered by existing transition measures.	Activities that are not currently consistent with the transition to an LCCR future. These include activities with moderate potential for emissions lock-in and risk of stranded assets.	Activities that are inconsistent with, and likely to impede, the transition required to achieve the long-term LCCR future. These activities have the highest emissions intensity, with the most potential for emissions lock-in and risk of stranded assets.
Example projects					
 Solar power plants	 Energy efficient buildings	 Hybrid road vehicles	 Health care services	 Conventional steel production	 New oil exploration

Note: For us to consider use of proceeds aligned with ICMA Principles for a green project, we require project categories directly funded by the financing to be assigned one of the three green Shades.

LCCR--Low-carbon climate resilient. An LCCR future is a future aligned with the Paris Agreement; where the global average temperature increase is held below 2 degrees Celsius (2 C), with efforts to limit it to 1.5 C, above pre-industrial levels, while building resilience to the adverse impact of climate change and achieving sustainable outcomes across both climate and non-climate environmental objectives. Long term and near term--For the purpose of this analysis, we consider the long term to be beyond the middle of the 21st century and the near term to be within the next decade. Emissions lock-in--Where an activity delays or prevents the transition to low-carbon alternatives by perpetuating assets or processes (often fossil fuel use and its corresponding greenhouse gas emissions) that are not aligned with, or cannot adapt to, an LCCR future. Stranded assets--Assets that have suffered from unanticipated or premature write-downs, devaluations, or conversion to liabilities (as defined by the University of Oxford).

Related Research

- [SPO Spotlight: Second Party Opinions](#), March 28, 2024
- [Analytical Approach: Second Party Opinions: Use of Proceeds](#), July 27, 2023
- [FAQ: Applying Our Integrated Analytical Approach for Use-of-Proceeds Second Party Opinions](#), July 27, 2023
- [Analytical Approach: Shades of Green Assessments](#), July 27, 2023
- [S&P Global Ratings ESG Materiality Maps](#), July 20, 2022

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