Kensington Mortgages

ESG Webinar
April 2021

Kensington

AGENDA

- Overview
- Green Mortgages
- EPC and Performance
- ESG Bond Market
- The Need for Standardisation
- Kensington’s Approach

Overview

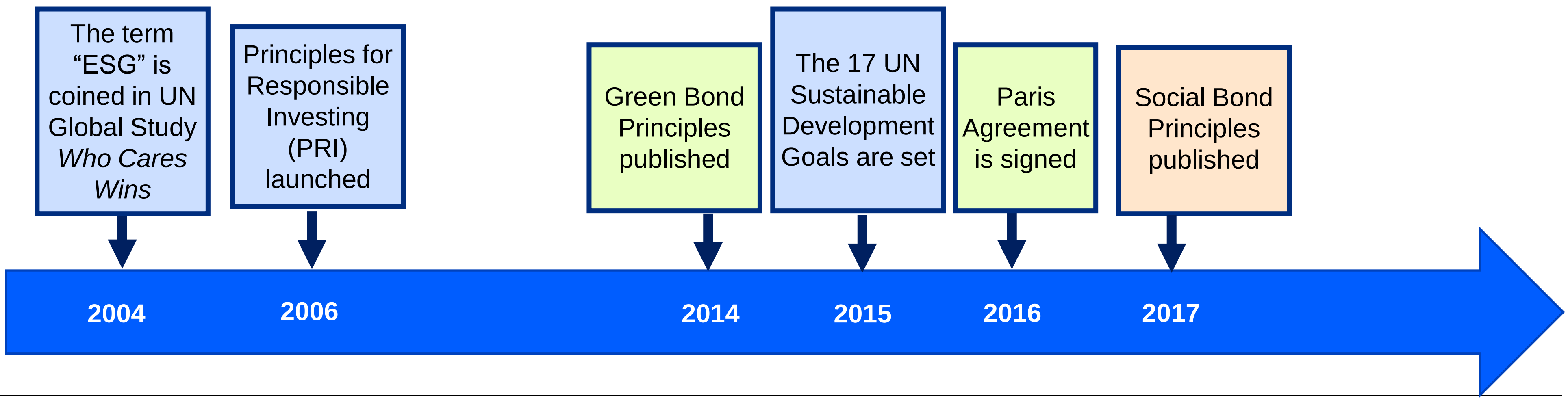
Kensington

Kensington

What is ESG?

More than just an acronym

- ESG brings together, under one umbrella, three separate measures on which products, practices and companies can be assessed
- The term "**ESG**" was coined in the 2004 report requested by then UN Secretary General Annan: *Who Cares Wins: Connecting Financial Markets to a Changing World*
    - The PRI was subsequently launched, with the aim to promote the integration of environmental, social and governance ("ESG") factors in investment analysis, alongside more traditional financial factors
- With a societal shift to ESG concerns, employees, consumers and investors increasingly judge businesses and products by their ESG credentials
    - This creates an increased need for these to be transparent, clear and standardised
- In Capital Markets, the ICMA Green Bond Principles (GBP) and Social Bond Principles (SBP) have become the leading frameworks globally for issuance of green, social and sustainability bonds



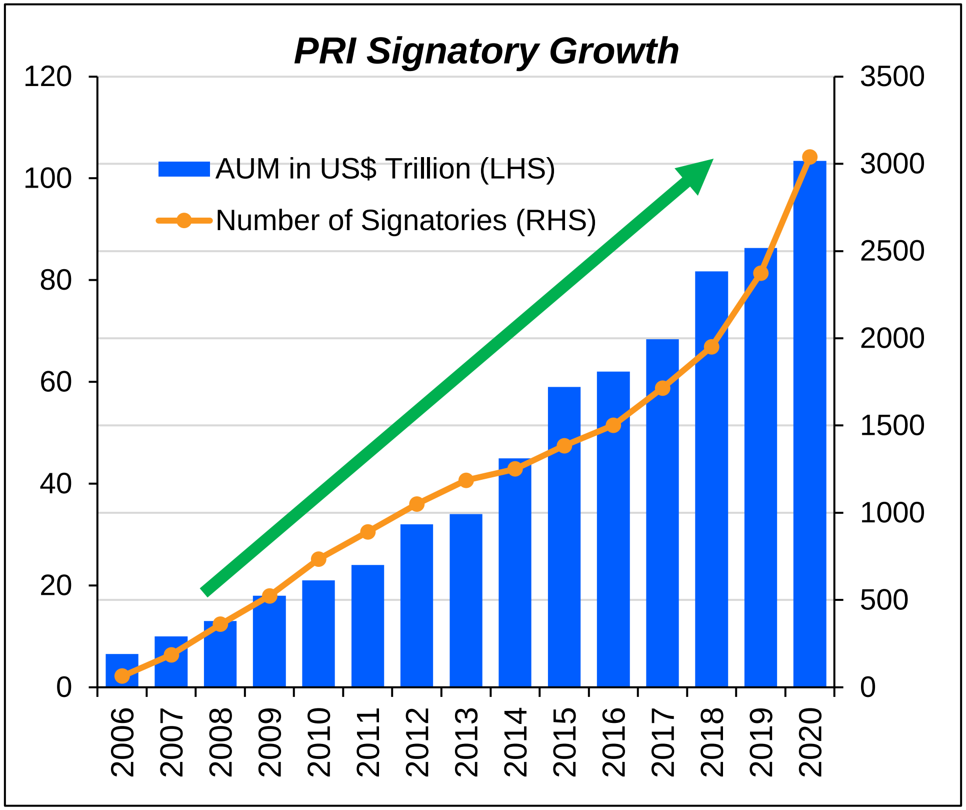
Growth of ESG

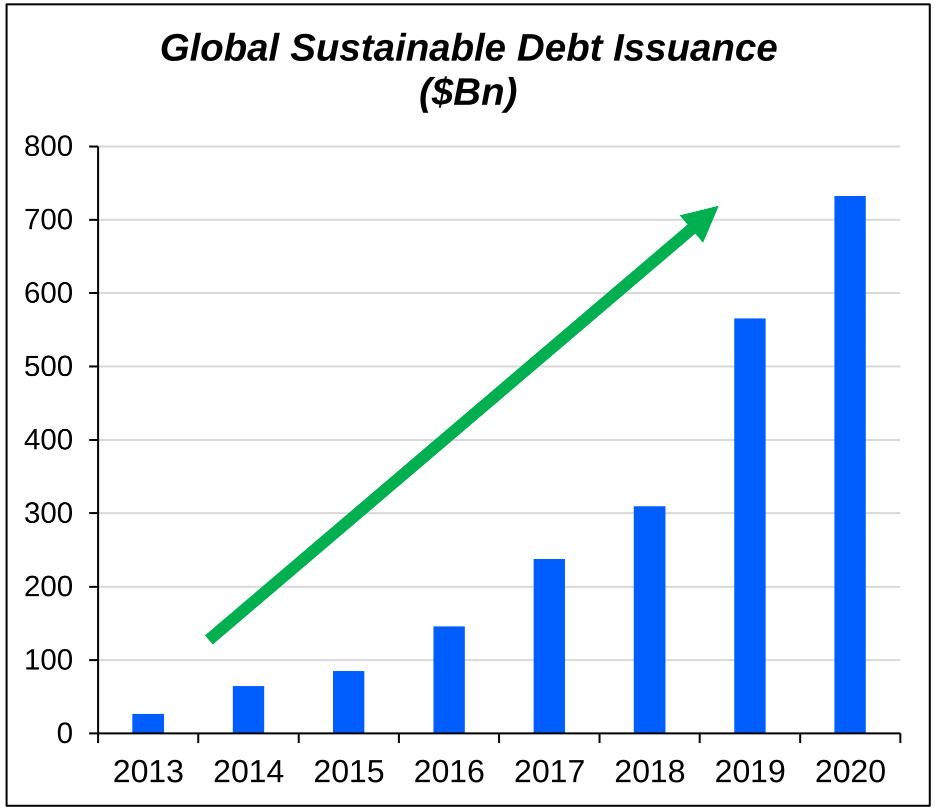
Kensington

From niche to mainstream

- Investors are increasingly showing their appetite for ESG Assets and commitment to ESG investing
- Since launching in 2006, the number of signatories to the PRI has increased from 63 with $6.5 Trillion AUM, to 3,038 with over $100 Trillion AUM

- Global Sustainable Debt Issuances (including green, social and sustainability bonds, sustainability-linked bonds, green loans, sustainability-linked loans) have grown significantly over the last decade





Source: Bloomberg

Green Mortgages

Kensington

Kensington

Green Mortgages

Who offers what?

- Green mortgages, or mortgages that take into consideration green factors, are relatively new in the UK market, with Barclays introducing the first product in 2018, and a number of lenders following with their own offering (including Kensington) in the last year

Residential Offering	Barclays	Kensington	Nationwide	Saffron Building Society	NatWest	Newbury Building Society	Foundation Home Loans
Product Name	**Green Home Mortgage**	**eKo Cashback**	**Green Additional Borrowing**	**Green Retro-Fit Mortgage**	**Green Mortgages**	**GoGreen Reward Self-Build Mortgage**	**Green Reward Remortgage**
Introduction Date	Apr-18	Feb-20	Mar-20	Sep-20	Oct-20	Mar-21	Apr-21
Max LTV Range	90% LTV 75% on HTB	85% LTV	90% LTV	80% LTV	85% LTV	75% LTV	85% LTV
Benefit	Rate discount (new build)	£1K Cashback	0.75% v 1.94% for comparable product	Fixed rate reduction of 0.1%	Rate discount & £250 cashback	Discounted rate & 50% refund of application fee	Preferential rates with £750 cashback & a reduced fee
Other Conditions	13 eligible partner housebuilders	Up to 12 months to make the energy improvements	£5,000 - £25,000	-	-	Postcode restricted	-
What Makes it Green?	**EPC rating of A or B**	**Improve EPC rating by 10 points in 12 months**	**50% of the loan used for energy efficiency measures**	**EPC improved by one band to a min. of E**	**EPC rating of A or B**	**EPC of A or B within 2years of start of the self-build project**	**EPC rating of A to C**

Data correct as at 14-Apr-2021

Green Mortgages

Kensington

Who offers what?

- Green BTL mortgages are an even newer phenomenon, and landlords are generally less likely to care about the energy efficiency of a property if they do not benefit from it themselves – although this is starting to change
- In April 2018, the Minimum Energy Efficiency Standards came into force requiring all rental properties of new tenancies and renewals to have a minimum EPC rating of 'E' or above – from 2020 this was extended to existing tenancies
- All new tenancies by 2025 and existing tenancies by 2028 must meet band C or higher

BTL Offering	**LendInvest**	**Paragon**	**Foundation Home Loans**	**The Mortgage Works (TMW)**	**Keystone Property Finance**
Product Name	**Bridge-to-Let**	**Green Further Advance**	**Green Reward**	**Green Further Advance**	**Green Mortgages**
Introduction Date	Mar-20	Feb-21	Feb-21	Apr-21	April 2021
Max LTV Range	75% LTV	75% LTV [£750k]	75% LTV	75% LTV	75% LTV
Benefit	Cashback ranging from £200 to £600	No application or product fees & free valuation	Preferential rates with £750 cashback & a reduced fee of 0.75%	Preferential rates	Preferential rates
Other Conditions	-	The landlord must have been accepted for a Green Homes Grant [now ended]	-	Max £15,000 Loan	Max £1M Loan
What Makes it Green?	**Rating movement from C or below to any grades above**	**The Grant covers 2/3 of the eligible work, up to a max of £5k; this product can be used to fund the remainder**	**Remortgage-only to rental properties with EPC rating of A to C**	**The loan must be towards one of a number of qualifying sustainable upgrades**	**5+ years with an EPC rating of A to C**

Data correct as at 14-Apr-2021

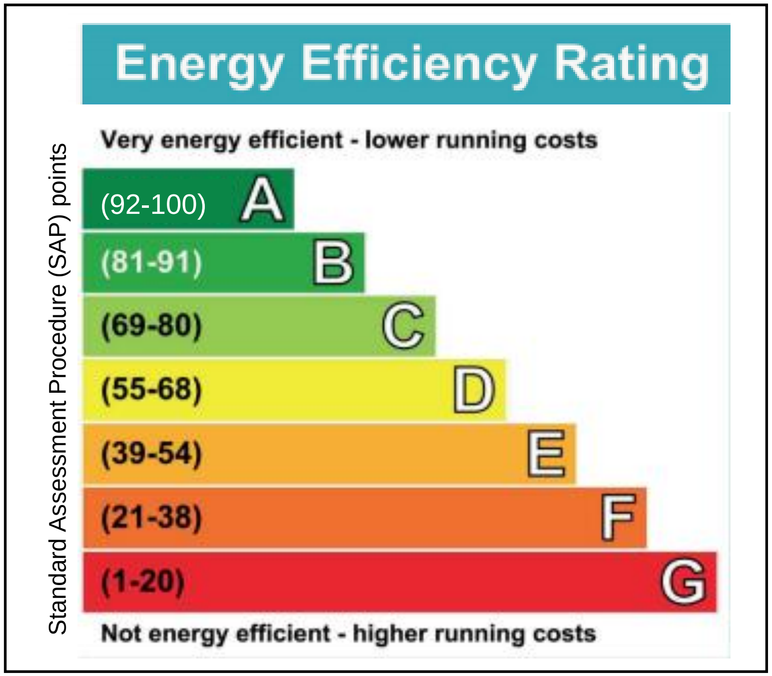
EPC and Performance

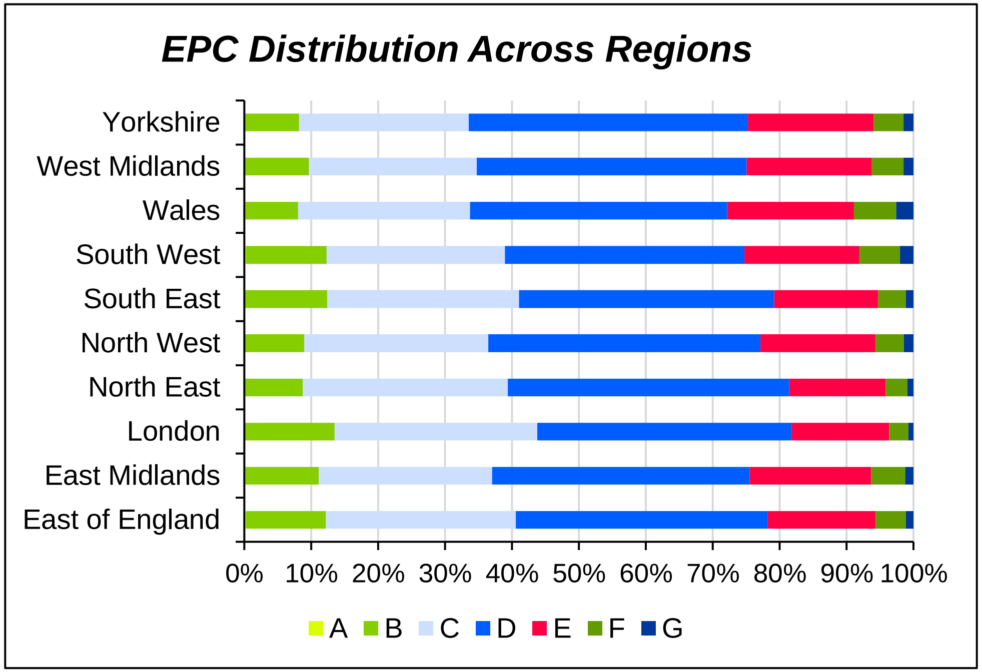
Kensington

EPC Ratings

What are they and why do they matter?

- An Energy Performance Certificate (EPC) indicates the energy efficiency of a building based on data about a building's energy features (for example, the building materials used and the heating systems and insulation), which are collected by an accredited energy assessor and are entered into a government-approved software to generate the EPC (using the Standard Assessment Procedure (SAP) methodology)
- EPCs were introduced in 2007 and are required on all dwellings when a building is **constructed, sold or let**, (They cost between £60-£120 typically) and are valid for 10 years.
- Since Q4 2008:
    - Over 20 million EPCs have been lodged, of which only 0.17% are A-rated and 10.94% B-rated



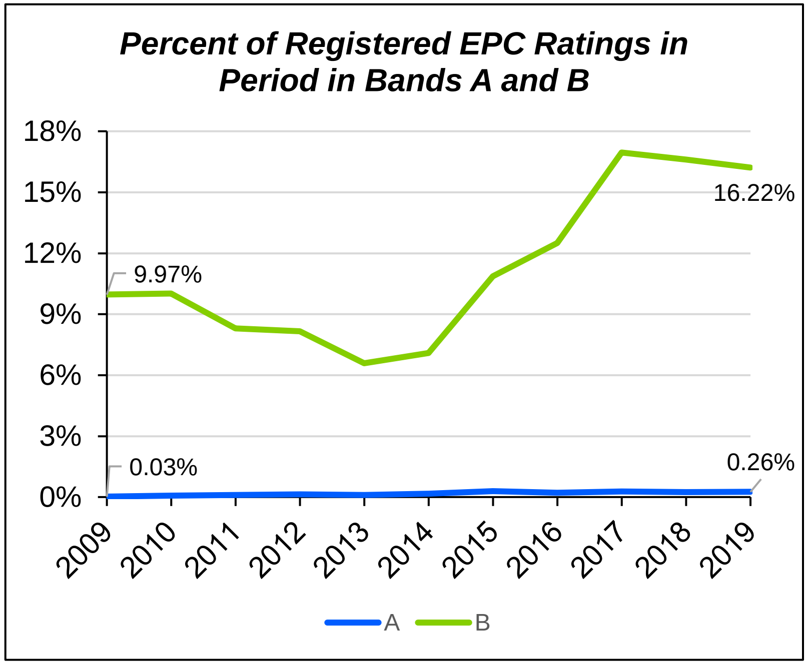


https://www.ons.gov.uk/peoplepopulationandcommunity/housing/articles/energyefficiencyofhousinginenglandandwales/2020-09-23
https://www.gov.uk/government/statistical-data-sets/live-tables-on-energy-performance-of-buildings-certificates
https://www.statista.com/statistics/378391/uk-england-housing-dwelling-stock-total/

EPC Ratings

Moving up, but slowly

- EPCs are an important instrument to enhance the market uptake of energy-efficient new buildings and the energy-efficient renovation of existing buildings
  - Most band A or B properties are New Builds, as homes are increasingly built to higher standards with better insulation and more energy efficient heating and appliances – this can make a significant difference in energy cost
- The share of properties in higher bands is increasing through time with c. 10% of registered EPC ratings in 2009 in Band B vs. over 16% in 2019, but Band A still only accounted for 0.26% of registered EPC ratings in 2019
- This means the number of green mortgages will likely stay similarly small in the near to medium term, but the market for products which encourage improvements may be more promising in the short term



Median EPC Rating by Property Type in England (2019)			
Existing flats	**Existing houses**	**New flats**	**New houses**
70	64	83	84

Energy Efficient Improvements[(2)]	Est. Cost	Potential SAP Increase
Hot Water Cylinder Jacket	£20-£50	1 – 5 points
LED Light Bulbs	£50 - £150	1 – 5 points
Loft Insulation	£100 - £400	10 – 15 points
Wall Insulation	£500 - £22,000	5 – 20 points
Renewable Energy	£1,500+	5 – 20 points
Double Glazing	£2,000 - £5,000	5 – 10 points
Boiler Upgrade	Varies £'000s	Up to 40 points

Green Mortgages

Kensington

Are they better performers?

BoE Research

- The BoE published a paper in 2018 concluding that mortgages against energy-efficient properties are less frequently in payment arrears
  - Based on 1.8million outstanding mortgages in 2017 mapped against EPC data
  - Conclude that savings on energy bills increase borrowers' disposable income, which offers them better protection from income shocks or unexpected expenses
    - They found 0.93% of mortgages on energy efficient properties are in arrears vs. 1.14% of energy-inefficient
  - They found the timing of origination accounted for some of the correlation and other factors such as financial literacy and risk appetite could also play a role

Annual Energy Costs by Type and Energy Efficiency of Property (BOE report estimates)

	High Energy Efficiency (A-C)	Medium Energy Efficiency (D)	Low Energy Efficiency (E-G)
2-Bed Flat	£417	£676	£1,023
3-Bed House	£578	£891	£1,340
4-Bed House	£695	£1,130	£1,775

KMC Portfolio

- EPC data on legacy portfolio not necessarily available and more recent originations tend to repay after teaser period leaving limited data
- Data based on 17,000 recent originations did not reveal a notable correlation between EPC ratings and arrears performance. This could be due to:
  - All loans being recent originations, which limited correlation in BoE research as well
  - Low arrears throughout the portfolio in general

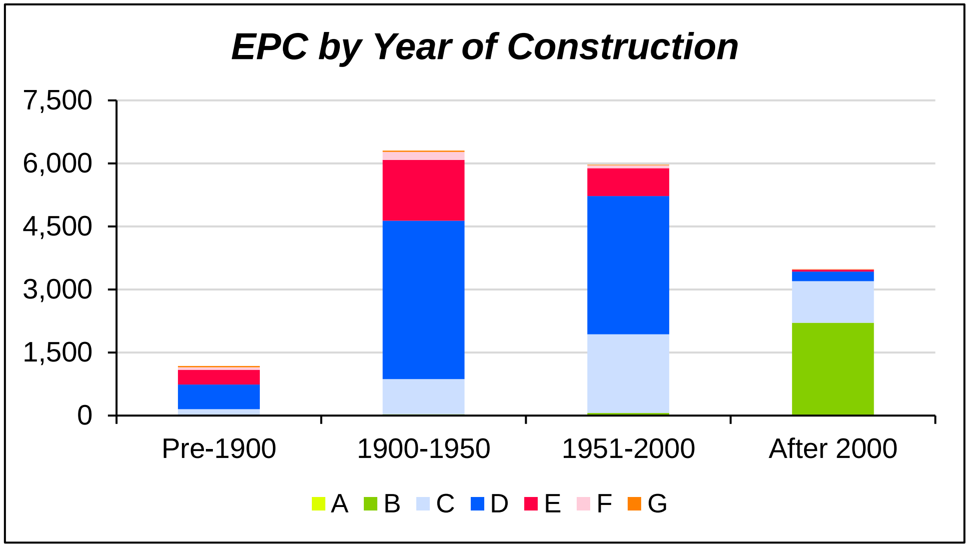
- The key difference we did find were that higher EPC ratings usually were correlated with higher incomes and higher property prices
- These loans may perform better by virtue of the customers being wealthier and having higher disposable incomes to begin with

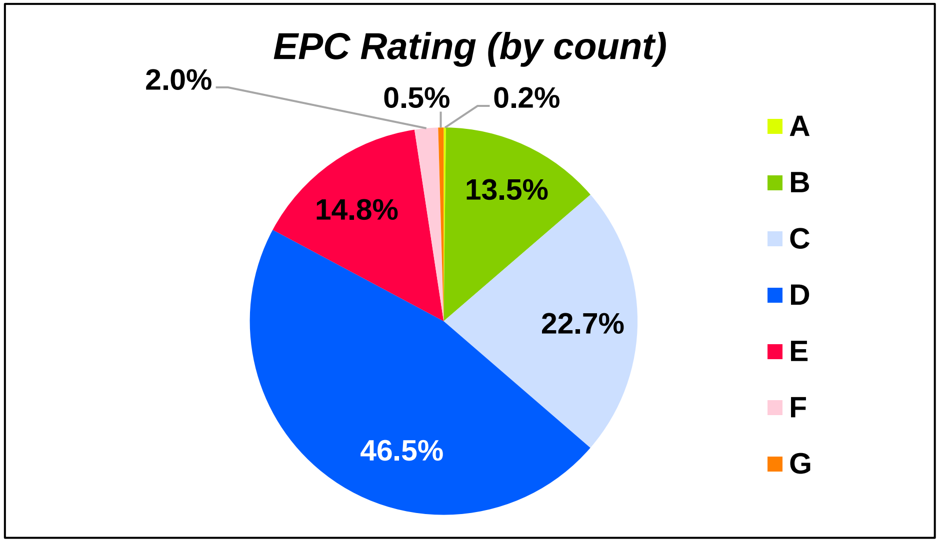
How Do We Compare?

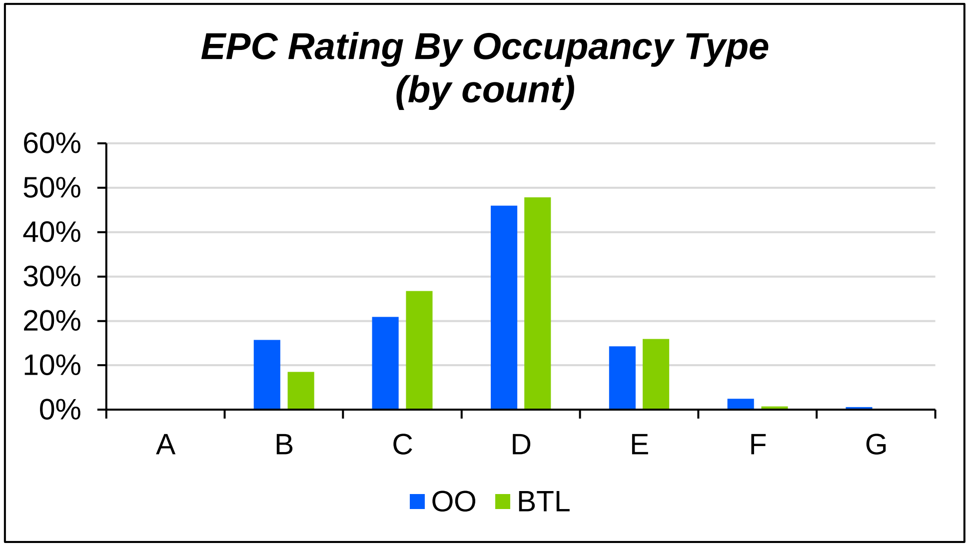
Kensington

Distribution of EPC Ratings for KMC Originations Jan-18 to Aug-20

- We looked at c. 17,000 KMC loans originated from the start of 2018 to August 2020
- The distribution broadly follows the overall UK market, with the largest proportion falling into the medium "D" category
  - Year of construction was the most significant determinant, with almost all B-rated properties built after 2000
- The distribution varied slightly between BTL and OO Loans, which a greater portion of OO loans following into the higher EPC rating of "B", and fewer in the lower ratings of "C", "D", and "E"





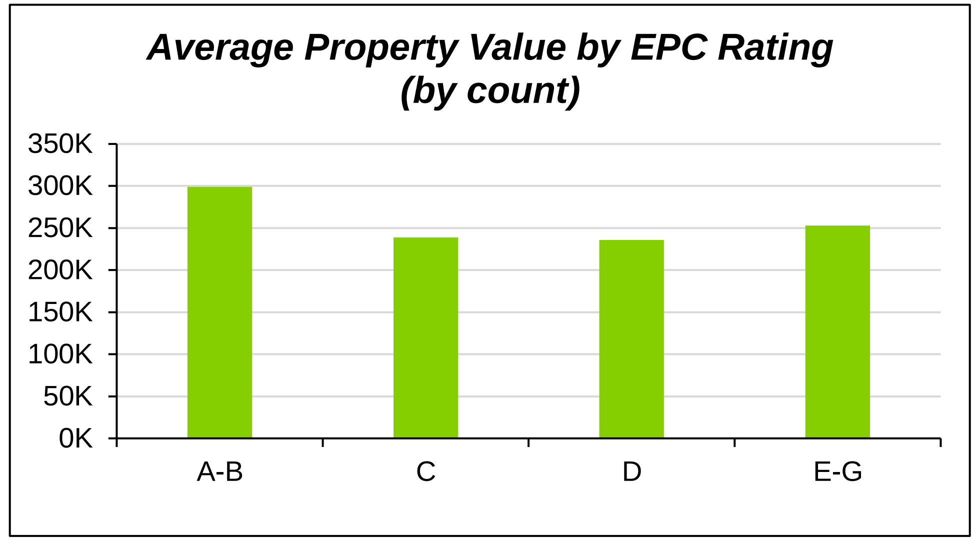


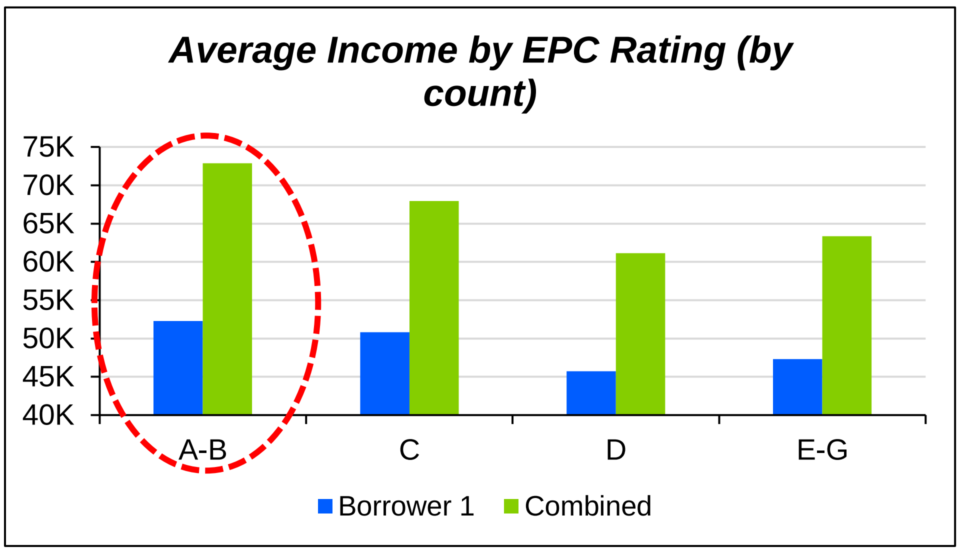
EPC Ratings and Borrower Characteristics

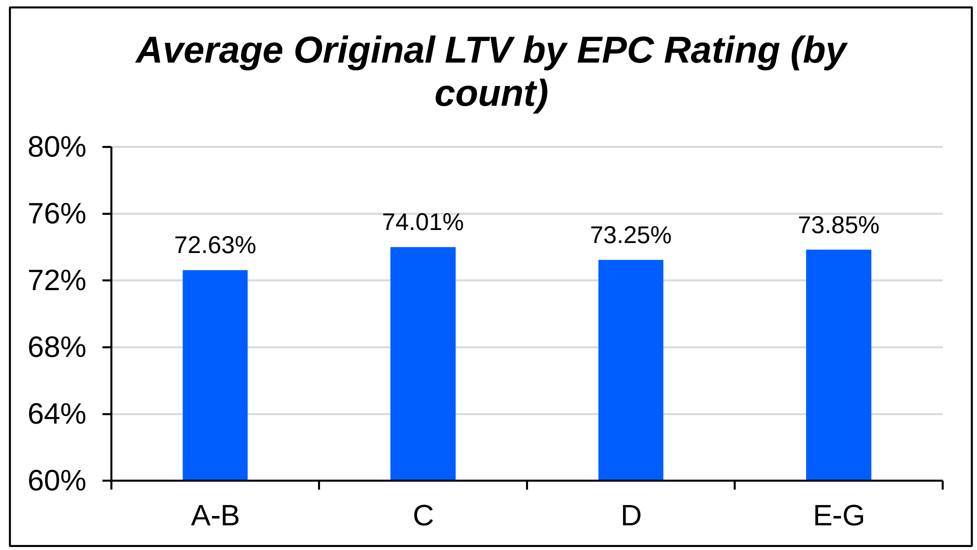
Kensington

Higher EPC-rated properties generally cost more and are owned by wealthier borrowers

- Customers with band A or B properties generally had higher incomes than those in bands C-G – this was true whether based on single or combined incomes
- The average A or B rated property is also more expensive than all other ratings, as would be expected with more recently built energy efficient homes
- We saw a slight variance in average LTVs, which were the lowest in the A-B group despite having the highest valuations







Kensington

ESG Bonds - Behind the Label

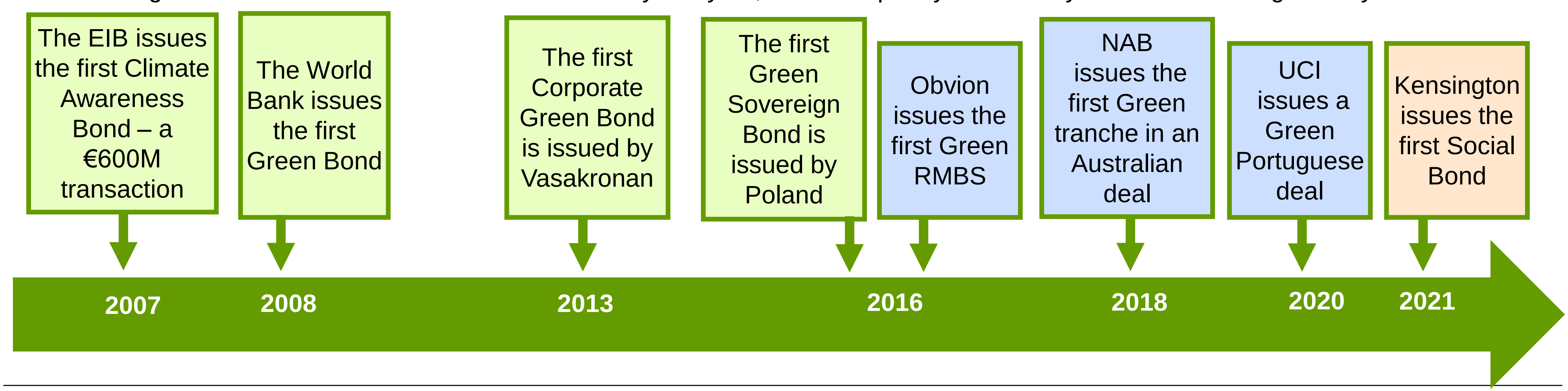
Kensington

ESG Bonds

Kensington

RMBS - Late Bloomers

- The European Investment Bank (EIB) and the World Bank pioneered the first green bonds
  - The EIB issuing the Climate Awareness Bond in 2007, the proceeds of which were earmarked for disbursement to renewable energy and energy efficiency projects
  - The World Bank issued the first Green Bond in 2008, the result of collaboration between investors, banks, and development agencies, which created the blueprint for today’s market by defining the criteria for eligible projects.
    - It formed the basis for the Green Bond Principles coordinated by International Capital Markets Association (ICMA)
- The first European Green RMBS wasn’t issued until almost 10 years later, by Dutch-based Obvion in June 2016
  - Obvion has since issued a new Green RMBS annually (with the exception of 2020)
  - Since then, a number of green RMBS tranches have been issued in Australia as well as a green privately placed RMBS in Portugal
  - Despite this we don't expect to see a large number of Green RMBS as the pricing benefit for issuers is not significant compared to issuing a Green Corporate Bond, or hybrid debt instrument
- Kensington issued the first Social RMBS in February this year, and was quickly followed by Yorkshire Building Society



Kensington

Green Bonds

Many shades of Green?

- While a number of RMBS have now been issued which are sold as “Green” or with a “Green” tranche, the label still has significant ambiguity, with different issuers in different regions using different criteria signed off by varying Second Party Opinion (SPO) providers and based on different country standards

	Green Storm 2017 to 2021	National RMBS Trust 2018-1	Pepper Residential Security Trust	Green Belém No.1
Sponsor	**Obvion (Rabobank Subsidiary)**	**National Australia Bank**	**Pepper**	**Unión de Créditos Inmobiliarios (UCI)**
Issuance Timing	2016, 2017, 2018, 2019, 2021	2018	2018, 2019	2020
Region	Netherlands	Australia	Australia	Portugal
Size/Number of Issuances	5 issuances (annually since 2016 except 2020)	Green tranche sized at AUD $300m in $2bn deal	Green tranches in PRS22, PRS23, PRS24, PRS25	Fully Retained Initially
SPO Provider	Sustainalytics	DNV-GL	Sustainalytics	Sustainalytics
What Makes it “Green”	• EPC Rating of A (or B for the 2016 and 2017 deals) which represents top 15% of market • EPC of B or C with 2-Step improvement compared to an average house within the same building period • Prior to 2021 deal, only open to “Green” investors	• Meet the Climate Bonds Standard for Australian low carbon residential buildings • Based on CBI proxy criteria for Australian low-carbon residential building, using year of construction to identify top 15% in the country • Includes only New Build • Tranche has 3yr WAL to ensure criteria continues to be relevant for life of the bond	• Meet the Low Carbon Buildings criteria when accompanied by certain third-party standards, ensuring the buildings are in the top 15% of the market in terms of building energy performance • Based on NSWs CBI-approved building codes as an eligible proxy in other states	• Committed to using an amount equal to the deal’s senior tranche to fund new green mortgages over 5 years • Backed by energy efficient buildings: A & B rated EPC properties, as well as mortgages for properties that make a 30% increase in their efficiency
Green %	100%	c. 24% of total deal	Range from 20% (PRS22) to c.31% (PRS25)	c.24% of deal rated A or B

Kensington

Social Bonds

Social standards?

- “Social” bonds are even newer, with Kensington bringing the first Social RMBS 2 months ago, shortly followed by Yorkshire Building Society - without a data centric measurement like EPC ratings, these are even more subjective

	Gemgarto 2021-1	Brass No. 10
Sponsor	**Kensington Mortgages**	**Yorkshire Building Society**
Type	Non-Bank	Bank
Issuance Timing	Feb-2021	Mar-2021
Region	UK	UK
Size/Number of Issuances	1	1
SPO Provider	ISS	S&P Global
What Makes it “Social”	• Aligned to ICMA Social Bond Principles • Improving access to home loan finance and facilitating home ownership for a target population • Target populations comprise viable borrowers that are underserved by high street banks despite their high quality profile – borrowers with multiple and/or complex incomes, self-employed, contractors, first-time buyers, later life & younger borrowers and borrowers looking to purchase affordable housing	• Aligned to ICMA Social Bond Principles • Targeted 75% of lending being “genuinely purposeful” by the end of 2024 • Improving access to banking services, socio-economic advancement and empowerment through equitable access to and control over assets, by making available higher rate savings products and/or competitively priced mortgage products to underserved segments • Target Customers are those using a savings product, FTBs, Self-employed, Contractors, or those requiring Later life/lending into retirement and Affordable housing

The Need for Standardisation

Kensington

Kensington

Kensington

EPC Standardisation

Availability and quality of data varies significantly by country

- Availability of reliable and standardized data such as EPC ratings is a key requirement to certify ESG compliance in a uniform way
  - e.g. in Australia, standard EPC certificates do not exist, and even within the European Union, these can vary country by country
- The UK has one of the most centralized and public EPC databases, but the possibilities this offers are not fully utilized as most lenders, including High Street banks, do not gather EPC data at the point of origination, and as a result do not share it
  - These types of issues are important to address as investors cannot be expected to familiarise themselves with the intricacies of rating systems in different geographies or seek out this data themselves
  - ESMA reporting requirements make the inclusion of EPC ratings mandatory, so we may see this change in the future as more lenders start to embed the collection of this data is their standard underwriting processes

	UK	Netherlands	Germany	Portugal	France	Australia
Central Database	Yes	Yes	No	Yes	Yes	No
Public Register	Yes	Yes	No	Yes	Limited	No
Official software used to calculate EPC	Yes	Yes	No	Yes	No	No
On-site Inspection Needed?	Yes, but only for existing buildings (not new buildings)	No	No	Yes	Yes	Varies across each state and assessment system
Assessor Training Required?	Yes	No	No	Yes	No	Varies across each state and assessment system

What’s Next?

Kensington

Standardisation and transparency are the path forward

- Currently, development of the ESG finance market is held back by both limited supply of ESG compliant collateral and the lack of standardised frameworks – we believe development of the latter will play an important role in driving forward the former
- There are some common shared standards for issuing ESG compliant instruments– for example, most SPO verifiers align their evaluations to the UNSDGs, and/or ICMA Green Bond or Social Bond Principles, but there is a real gap at firm level disclosures
  - Objective comparisons and due diligence are difficult without standardisation of frameworks or checklists on which issuers are assessed
- This problem has been recognised, and the Association for Financial Markets in Europe (AFME) is actively working on pushing forward standardised ESG disclosures, both for ESG-labelled investments and the broader market

Pre-”ESG”-Labelling

Firm Level
- Corporate Governance Frameworks are important, with limited attention to Climate or Social considerations

Asset Level
- Sustainable Investments characterised by exclusion of instruments seen as negative rather than investing in positive products

Current ”ESG-Conscious” Market

Firm Level
- Climate and Social considerations have joined Governance as an important assessment measure
- Individual Firms are starting to set meaningful and measurable –but individual - goals

Asset Level
- Certifying mostly *existing* positive behaviour to varying individual standards
- Limited pricing benefit

Fully-fledged ESG Finance Market

Firm Level
- Standardised ESG frameworks for assessments, so that different companies can be compared on a like for like basis on relevant criteria for their industries

Asset Level
- Standardised certification criteria meaning all “Green” or “Social” bonds are held to the same standard
- Move away from simply certifying existing behaviour to actively originating ESG assets
- Appropriate pricing benefit

Kensington’s Approach

Kensington

Corporate Kensington ESG Targets

Publicly released in August 2020

ENVIRONMENTAL

CONTROL CARBON EMISSIONS

Implementation of energy saving initiatives to reduce our carbon emissions. **Target reduction of 20% by 2025 (vs 2019)** across both London and Maidenhead offices. This will be achieved through better electricity consumption and water usage. Increase paperless working to **reduce paper waste** generated by the Group by **a minimum of 20% by 2025 (vs 2019)**

RECYCLING

Reduce the amount of landfill waste generated **by recycling at least 30% of all waste** (including paper)

ENVIRONMENTAL FRIENDLY MORTGAGE PRODUCT – eKo CASHBACK MORTGAGES

Target to **give £1,000 cashback to at least 30% of borrowers** that selected the eKo cashback mortgage to help drive energy improvements in existing UK homes

SOCIAL

LENDING PLATFORM – MORTGAGE PRODUCTS THAT TARGET SOCIAL BORROWERS

Continue to provide mortgage financing to an underserved population of UK home owners in line with the definition from the Social Bond Principles (SBP) 2018 from ICMA.
Aim for at least 50% of our owner occupied lending to be to social borrowers including self employed, later life, young professionals and heroes (key workers)

CHARITY

Each employee receives one day per year for volunteering.
Our aim is **for at least 10% of staff to take up this volunteering day**

GENDER DIVERSITY

Gender diversity in senior roles is important to Kensington and so we will aim **to shortlist an equal proportion of female and male candidates for senior manager and executive roles**

EMPLOYEE WELLBEING

Target an average 85% score for the Well Being section of the annual employee engagement survey

GOVERNANCE

DATA PROTECTION

Protection of our customer data is key. To ensure this we will **comply with GDPR and DPA2018**
Maintain the **ISO 270001 certification** (last received in December 2019)
Cyber security is key to the operation of the firm and protection of data. We aim to achieve and maintain the '**Cyber Essentials Plus**' accreditation

GOVERNANCE STRUCTURE

Kensington's Board will continue to consist of a majority of **independent non-executive directors**.
External auditors (currently KPMG) will undertake an annual audit of Koala Cayman (parent company of Kensington);
No unqualified opinion received from auditors in the last 5 years

CORPORATE RISK MANAGEMENT

Continue to have an **independent risk management function** and a 'three lines of defence' governance model which is best practice.
Compliance with the **SMCR** (Senior Managers & Certification Regime) conduct rules from the FCA

Kensington will monitor and publicly report at the end of its FY 20/21 the levels for each of its Environmental, Social and Governance targets

ESG Targets – FY 2020/21

Kensington

Environmental

Status	TARGET'S AREAS	DEPARTMENT	COMMENTS	TRACKING
ACHIEVED	REDUCE ENERGY CONSUMPTION by 20% by 2025	HR	- Electricity consumption only - Exclude water usage given it is done on the basis of premise's apportionment so no data on the actual consumption of water	- FY19-20: Use of 1,684k Kwh - FY20-21: Use of 1,302k Kwh (across both offices) - Reduction by 23% of electricity
ACHIEVED	REDUCE PAPER WASTE BY 20% BY 2025	HR	- Paper includes onsite and offsite printings	- FY19-20: total of 6m pages printed // FY20-21: total of 3.8m pages printed - Reduction by 37% of paper generated
ACHIEVED	RECYCLING 30% OF ALL WASTE	HR	- Total waste include general waste and confidential waste - Waste data incl. Maidenhead only except confidential paper which is tracked for both offices - The landlord in London manages the general waste so we do not have any data on recycling	- Total waste generated is 18,077 kg - Total recycled waste is 15,229kg - Kensington recycled 84% of its total waste tracked
COVID CHALLENGED	REWARD 30% OF EKO CASHBACK BORROWERS WITH £1,000	PRODUCT	- Product relaunched in September (was withdrawn in March-20)	- £19.5m completions (144 loans) - No borrower has claimed the £1,000 cashback yet given current COVID-19 restrictions

ESG Targets – FY 2020/21

Kensington

Social

STATUS	TARGET'S AREAS	DEPARTMENT	COMMENTS	TRACKING
ACHIEVED	LEND 50% OF OO NEW PRODUCTION TO SOCIAL BORROWERS	CAPITAL MARKETS	ISS (third party opinion provider) confirmed Kensington's social bond framework is aligned with the Social bond criteria of ICMA and contributes to the achievement of the UN SDGs	100% of Kensington OO loans originated post-crisis provide clear social benefits for the borrowers that are considered underserved
COVID CHALLENGED	10% OF STAFF TO TAKE UP THE VOLUNTEERING DAY	HR / MARKETING	Given the multiple lockdowns and associated restrictions, several employees had to cancel their planned volunteering day	- 33 employees have completed their volunteering day i.e. total of 6.3% of staff
COVID CHALLENGED	SHORTLIST AN EQUAL PROPORTION OF MALE AND FEMALE FOR BAND D ROLES	HR	Only 2 senior roles were offered since the beginning of the fiscal year: CFO role and Head of Technology Services In Band A, we recruited a total of 67 people since Apr-20 of which 62% are female	2 senior recruitments only - CFO role: 4 male candidates shortlisted (no female) - Head of Technology services: 50/50 shortlisted candidates Given the pandemic, the Group froze its recruitment's process during the first 6 months of 20/21
ACHIEVED	WELLBEING	HR	Kensington did 2 pulse surveys in May-20 and Jan-21 where respectively 86% and 83% of employees participated	The agreement score for the wellbeing section was respectively 88% and 86% (>85%) – ETS benchmark is 77%

Kensington

ESG Targets – FY 2020/21

Governance

	TARGET'S AREAS	DEPARTMENT	COMMENTS	TRACKING
PARTIAL	DATA PROTECTION	OPERATIONS / IT	Kensington continuously complies with GDPR and DPA2018 regulations (2 satisfactory audits undertaken by BDO in 2019 and 2020 to confirm adherence to data protection legislations)	The ISO27001 certification was last received in Dec 2019 and lasts for 3 years (expiry in Dec-22) – 6 month review in Nov-20 confirming our adherence to the certification The Cyber Essentials Plus accreditation is now targeted to be achieved by Dec-21 (after the digital transformation of the Finance area is completed)
ACHIEVED	GOVERNANCE STRUCTURE	Legal / Finance		No unqualified opinions received from auditors in the last 5 yrs Kensington Board consists of independent non-executive directors
ACHIEVED	CORPORATE RISK MANAGEMENT	RISK		Kensington has an independent risk function and a 3-line of defence governance model; Kensington complies with the SMCR conduct rules from the FCA