

# **IBERDROLA FRAMEWORK FOR GREEN FINANCING**

**May 2019**

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## I. INTRODUCTION

### 1. Rational

For the last two decades, and in anticipation of the energy transition, Iberdrola has been developing sustainable solutions to support the increasing electrification of the global economy: more clean energy, more storage capacity, more backup power, more and smarter grids, and more digitalisation. Today the company is a benchmark in the fight against climate change.

This position was ratified in 2017 and 2018 with Iberdrola's active presence at the Bonn and Katowice Climate Summits, where it became clear that it is time to move from words to action to accelerate the energy transition towards a sustainable, secure and competitive model that replace production with polluting sources by clean energies, and intensify the electrification of the world economy.

The protection of the environment and the commitment to sustainable development have set priorities over the past years. Thus, the company has increased its installed capacity free of emissions to exceed 32,000 MW, 68% of the total. Although the emissions per kWh generated are already some 30% below the average for the European electricity sector, Iberdrola has set the goal of a 50% reduction by 2030 (vs 2007) and to reach carbon neutrality by 2050. In addition, in 2018 close to 270 million euros were invested in innovation for the development of new clean generation technologies, the increase in efficiency and the development of innovative services to our customers, positioning the company as one of the four utilities in the world in terms of R&D investment. On 23 May 2018 Iberdrola held the first *Innoday 2018* event, the energy sector's major innovation roadshow, on the company's international campus.

Iberdrola's sustainability performance is well recognized by prestigious indexes such as the FTSE4Good, the CDP Climate Change or the Dow Jones Sustainability, being the only European electricity company included in its 19 editions.

In the coming years, the company will continue to deploy its business model, with more investments in renewable energy, in smart networks, efficient storage and innovative solutions for its customers in order to achieve these above-mentioned targets. Iberdrola plans to invest in those areas more than 34,000 million euros in the period 2018-2022, which will drive results growth and strengthen its position *and leadership*, firmly committed to the Sustainable Development Goals of the United Nations, which have been fully incorporated into our business strategy.

In this context, "Green financing" is a valuable tool that the company will use to develop its investment plan while giving investors the transparency to better allocate their funds and the ability to measure their contribution to sustainability.

Iberdrola aims to apply the highest standards in every activity it performs, and does so for Green Financing. With this objective, the company has designed, approved and implemented a set of procedures that jointly form the "***Iberdrola Framework for Green Financing***" (*hereafter the "Framework"*). This Framework has been created to facilitate transparency, disclosure and integrity of Iberdrola's green financing initiatives.

### 2. Scope

This ***Framework*** defines how Green Financing instruments are set up within the Iberdrola Group from date of publication. For the purpose of this document, Avangrid

(the US company controlled by Iberdrola, S.A. and listed in the New York Stock Exchange) and Neoen (the Brazilian company controlled by Iberdrola, S.A.) are excluded and subject to their own Green Financing framework.

Green Financing instruments issued prior this Framework publication (since April 2014 to 2017) followed similar project selection and reporting procedures. However, to assure maximum homogeneity, the company will report them according to this Framework to the extent that is possible. This includes to adapt its annual reporting and to include them in the annual assurance as described later.

Potential **Green Financing instruments** include green bonds (green use of proceeds bonds), green loans, green project finance and any other financial instrument to which an eligible asset or project, or a group of those, are allocated.

The company could eventually update this Framework, and commits that any new version will keep or improve current levels of transparency and reporting (with the corresponding review by an external consultant) and that it will be publicly disclosed in its website.

### 3. Principles and general guidelines

The Framework is inspired by, and intends to follow the **Green Bond Principles** (“GBPs”) published by the International Capital Markets Association (ICMA<sup>1</sup>). Due to this, the procedures implemented by this Framework cover the areas of “Use of Proceeds”, “Projects Evaluation and Selection”, “Management of Proceeds”, “Reporting” and “External review”.

The Iberdrola Group comprises of a number of operating subsidiaries in which assets reside. Some subsidiaries have minority shareholders and possibly their own indebtedness. Besides, during the lifetime of the asset, transfer of ownership or changes in the capital structure of the subsidiaries can arise.

Considering the foregoing, and with the objectives of avoiding double counting and assuring transparency, the following **general guidelines** will be followed:

- **Green Financing instruments should not be considered fungible with other financing instruments** that are not aligned with the 4 core components of the Green Bond Principles.
- **Each eligible asset or project can be allocated to one or several Green Financing instruments** within the Iberdrola Group scope. Iberdrola will implement a control system to assure coordination in assets allocation and avoid double counting.
- For each asset or project, the sum of the invested capital allocated to different Green Financing instruments must fulfill the following restriction:

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<sup>1</sup> <https://www.icmagroup.org/>

**Allocated capex to Green Financing  $\leq$  (total asset capex - external debt<sup>2</sup>) x percentage of Iberdrola Group's ownership.**

Therefore, only the pro-rated share (as a percentage of the issuer's share of the total financing) of the total results would be included in the bond and in the impact reporting.

- If, as a consequence of a **change of the ownership or capital structure**, previous rule is not fulfilled, the company commits to **restructure** the allocation by substituting the excess with an alternative Eligible Green Project (as defined below).
- When a Green Financing instrument is matured, **allocated eligible projects can be refinanced** and re-allocated into new Green Financing instruments.
- If an asset reaches the **end of its lifetime**, or definitively stops operations during the period of financing, the company commits to **substitute** that asset with an alternative eligible asset.
- If any **material and critical controversies<sup>3</sup> emerge**, in relation to a specific asset, the company commits to substitute that asset with an alternative eligible asset.
- In the case of **divestments** or if a project no longer meets the Framework, the funds will be reallocated to other Eligible Green Project (as defined below).

## II. PROCEDURES

### 1. Use of proceeds

The **net proceeds** of Green Financing instruments will be used to finance, or refinance, in whole or in part, Eligible Green Projects (including other related and supporting expenditures).

**Eligible Green Projects** are included in the following categories:

- a) **Renewable energy projects**: financing of, or investments in development, construction, installation and maintenance of renewable energy production units from wind (onshore and offshore) and solar (photovoltaic or CSP) sources.
- b) **Smart grids** projects.
- c) **Transmission and Distribution Networks projects** with the purpose of connecting renewable sources, improving efficiency, decreasing losses or extending access to electricity.
- d) **Hydroelectric facilities** (including hydro-pumping stations and repowering of operating assets), fulfilling strict selection criteria, as described below.

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<sup>2</sup> External debt which is specifically financing the Eligible Green Project.

<sup>3</sup> The Second Party Opinion will define and analyze the controversial activities in which Iberdrola is involved, as well as Stakeholder-related ESG controversies related to the eligible assets for each Green Bond.

All Eligible Green Projects are deemed to provide environmental benefits that contribute to: (i) avoiding CO<sub>2</sub> emissions, (ii) connecting renewable energy production units to the general network, (iii) improving networks in terms of demand-size management, energy efficiency and access to electricity or (iv) ensuring the stability and back up of generation systems with significant renewable energy penetration. These benefits will be assessed and, where feasible, quantified by Iberdrola annually in the corresponding reporting (see Section 4 below).

The list of Eligible Green Projects related to the contemplated Green Financing instrument will be disclosed with their main features.

Iberdrola, in consistency with the Green Bond Principles, considers as **Eligible Green Project** those projects that comply with the **Eligibility Criteria** (as defined below).

The company may, at any time, extend the list of Eligible Green Projects to other type of assets which provide verifiable sustainability benefits. In this case, the company commits to update the current Framework and to extend the set of criteria to appropriately analyze the new asset class.

## 2. Projects evaluation and selection

**Eligibility Criteria** include a set of both exclusion criteria and selection of environmental and social criteria which the Eligible Green Project must meet to be financed or refinanced by Green Financing instruments

The process for the evaluation and selection of eligible projects uses internal expertise:

- The respect of use of proceeds requirement, i.e. the definition of Renewable Energy Project is double checked by the Business and Financial teams.
- The project fulfilment with Iberdrola's CSR and Sustainability policies and the absence of any ESG matters are double checked by the Sustainability team (application of the exclusion criteria).
- The list of selected Eligible Projects is set up by Business and environmental teams, based on internal expertise, and submitted to the Finance Department for validation and selection. Finance Department checks with Sustainability Department, Legal and Corporate Social Responsibility (among others) if the projects are available, and checks internally that double counting is avoided.

This process is performed and coordinated by Iberdrola's Finance and Treasury Department and it is graphically described in Annex 2. This Department relies on different representatives for the assets selection, involving several areas of the Iberdrola Group, as for instance, Sustainability, Investor Relations, Procurements, Legal, Renewables and Networks teams (but not limited to those).

Projects evaluation and selection take the following main steps for each asset or project:

1. **The asset or project must be eligible**, as defined in this Framework, which means that must be aligned with both the selection and exclusion criteria:
  - **Alignment with the selection criteria**<sup>4</sup> at project level (as described in Annex 3) must be done and documented, applied to identify and manage

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<sup>4</sup> For hydroelectric projects, selection criteria (as described in Annex 3) will be based on recognized international standards.

potentially material environmental and social risks associated with the projects.

- An exclusion criteria is applied in case of any material litigation related to ESG matters, based on the integration of ESG factors at project level.
2. **Expected benefits** must be assessed and calculated.
  3. **The projects evaluation** must cover the project lifecycle, including the conception, the construction, and the full operation time.

### 3. Management of proceeds

For this milestone Iberdrola considers essential to avoid double counting and assure transparency. For such purposes, proceeds will be managed in different ways, depending on the stage of development and disbursement of the selected assets or projects:

#### A. Refinancing operating projects

In this case, and considering that projects costs were fully disbursed in the past, no separate management of proceeds is required. Iberdrola is committed to perform an external assurance of the already invested capital from the accounting records in order to check the correct use of proceeds.

The projects to be refinanced will have always been commissioned at a date where all Eligibility Criteria were met.

#### B. Projects under development

Proceeds aimed at projects under development will be managed also depending on the specific circumstances:

- a. For the already disbursed costs of development, no separate management of proceeds is required. Iberdrola is committed to perform an external assurance of the already invested capital from the accounting records in order to check the correct use of proceeds.
- b. For future project costs, Green Financing proceeds are managed through a dedicated tracking process aiming to ensure traceability. Upon receipt by the Financing and Treasury department of Iberdrola, proceeds from each issuance are invested in short-term financial assets until allocation to Eligible Green Projects. Until full allocation, Iberdrola will disclose the amount equal to the net proceeds unallocated to an Eligible Green Project which will be held temporarily in any form of cash, time deposit with banks or other form of available short term liquid funding sources which will not include GHG intensive or controversial activities. Complete allocation of the proceeds from a Green Financing instrument is expected within 24 months from the issue date. Iberdrola is committed to perform an external assurance of the invested capital once the corresponding proceeds are allocated from the accounting and treasury records in order to check the correct use of proceeds.

## 4. Reporting

For each Green Financing instrument, Iberdrola is committed to report annually, and until the maturity date on:

I. **Use of the Green Bond proceeds**

- i. **List of projects** with some individual information.
- ii. **Total funds allocation** (with breakdown per project category and breakdown of the allocation of proceeds between finance or refinance).

II. **Benefits in sustainability**

The company will publish annually a set of **reporting indicators** to describe the achieved benefits in sustainability. The type of indicators will depend on the type of asset or activity financed by green instrument.

Next charts include an exhaustive description of the reporting indicators per asset category related to sustainability benefits indicators.

III. **Assurance of compliance of selected projects with the Framework for Green Financing**

The company will annually assess the compliance with this Framework, including a description of material exceptions, controversies, and mitigating actions.

For Green Financing instruments publicly traded the reporting will be publicly disclosed within Iberdrola's annual Sustainability Report.

Type of Project	Benefits	Reporting Indicators
<p><b>a) Renewable energy projects and d) hydroelectric facilities</b></p>	<p>Climate Change mitigation</p>	<p>Per installation:</p> <ul style="list-style-type: none"> <li>• Name</li> <li>• Type of project</li> <li>• Country</li> <li>• Operational date</li> <li>• Installed capacity (MW) or lifetime extension (years)</li> <li>• Attributable capacity (MW) or attributable lifetime extension (years) to the financing instrument</li> </ul> <p>For each category</p> <ul style="list-style-type: none"> <li>• Invested capital attributable to the Green Financing instrument (€)</li> <li>• Percentage of allocated proceeds vs unallocated proceeds (if there are) (%)</li> <li>• Annual attributable renewable energy produced (MWh)</li> <li>• Annual attributable GHG emissions avoided (tCO<sub>2</sub>e<sup>5</sup> per year)</li> </ul>

<sup>5</sup> Avoided emissions are calculated as the product of the year's production attributable to the bonds and the emission factor for the country in which the assets are geographically located

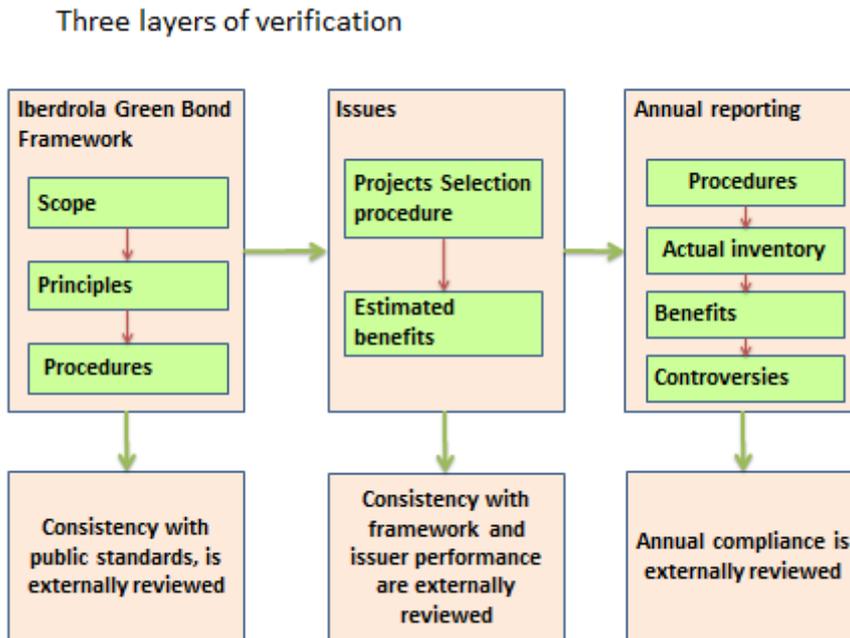
Type of Project	Benefits	Reporting Indicators
<b>b) Smart grids projects</b>	Climate Change mitigation	<p>Per project:</p> <ul style="list-style-type: none"> <li>• Name</li> <li>• Country</li> <li>• Description</li> <li>• Physical indicator i.e.               <ul style="list-style-type: none"> <li>○ Smart meters (total and attributable number),</li> <li>○ Telecommunicated substations (total and attributable number),</li> <li>○ T&amp;D lines (total and attributable km of lines).</li> </ul> </li> </ul> <p>For the category</p> <ul style="list-style-type: none"> <li>• Invested capital attributable to the Green Financing instrument (€)</li> <li>• Percentage of allocated proceeds vs unallocated proceeds (if there are) (%)</li> </ul>

Type of Project	Benefits	Reporting Indicators
<b>c) Transmission and Distribution Networks with the purpose of connecting renewable sources, improve efficiency, decrease losses or extend access to electricity</b>	Climate Change mitigation	<p>Per project:</p> <ul style="list-style-type: none"> <li>• Name</li> <li>• Country</li> <li>• Description</li> <li>• Physical indicator i.e.               <ul style="list-style-type: none"> <li>○ T&amp;D lines (total and attributable km)</li> <li>○ increase of T&amp;D capacity (total and attributable MW)</li> </ul> </li> </ul> <p>For the category</p> <ul style="list-style-type: none"> <li>• Invested capital attributable to the financing instrument (€)</li> <li>• Percentage of allocated proceeds vs unallocated proceeds (if there are) (%)</li> <li>• When applicable and possible, amount of renewable generation capacity connected by the T&amp;D asset (MWh)</li> <li>• Related annual renewable energy produced by the capacity connected by the T&amp;D asset (MWh)</li> <li>• Annual GHG emissions avoided by the renewable generation capacity connected by the T&amp;D asset (tCO<sub>2</sub>e per year)</li> </ul>

## 5. External review

To allow investors to follow the information related to green bonds, Iberdrola will provide this information on its website <https://www.iberdrola.com/shareholders-investors/investors/fixed-income/information-related-to-green-bonds>.

Graphically, the three layers of external review:



Iberdrola's Green Financing issuance is supported by three external reviews, depending on the type of instrument:

**1) Second Opinion on the Framework for Green Financing**

The Framework will be reviewed by a third party to assure its consistency with the Green Bond Principles and best market practices. The review will take place whenever the Framework is updated.

**2) Second Opinion on the issuances**

At the time of a new publicly<sup>6</sup> traded instrument issuance, the company will provide the preliminary list of assets or projects to be financed to review by a third party. This review will take form of Second Party Opinion, and its main content will be to ensure:

- a) Alignment of the issuance with the Green Bond Principles.
- b) Green credentials and alignment of projects with the objectives and criteria set by this Framework, including the analysis of the related ESG controversies at the date of the issuance.
- c) Disclosure on the overall company ESG performance.

The Second Party Opinion will be publicly available on Iberdrola website, or at least provided to investors/lenders.

**3) Annual assurance**

Annually, the Framework will be verified by an auditor. This independent assurance will cover:

- a. The review of the implementation of the procedures, including the consideration and internal documentation of the eligibility criteria, described in this Framework, and the final list of assets or projects.
- b. The review of the part of the invested capital attributable to each reported financing instrument.
- c. The tracking of the proceeds, when required.
- d. The review of the indicators describing the reporting of sustainability benefits.
- e. The review that the ESG controversies were analysed in the Second Party Opinion related to the allocated assets or activities.

For Green Financing instruments publicly traded, the annual assurance will be published jointly with the report of sustainability benefits as an annex to the Sustainability Report at Iberdrola's website.

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<sup>6</sup> In case of Green Loans, or Green Project Finance, the counterparty is expected to conduct the required verifications prior to closing, and following their own procedures.

### III. ANNEXES

#### 1. Annex: Iberdrola' s Sustainability Policies

The Board of Directors of IBERDROLA, S.A., as part of its Corporate Governance system, has approved and implemented relevant policies regarding Sustainability and Corporate Social Responsibility. The Corporate Social Responsibility Policies intend to favour a culture of social responsibility within the Group, on a global basis, which contributes to the sustainable creation of value for society, citizens, customers, shareholders, and the communities in which the Group does business, equitably compensating all groups that contribute to the success of its business enterprise, and to make new investments considering their social return, generating employment and wealth for society with a long-term vision that achieves a better future without compromising present results.

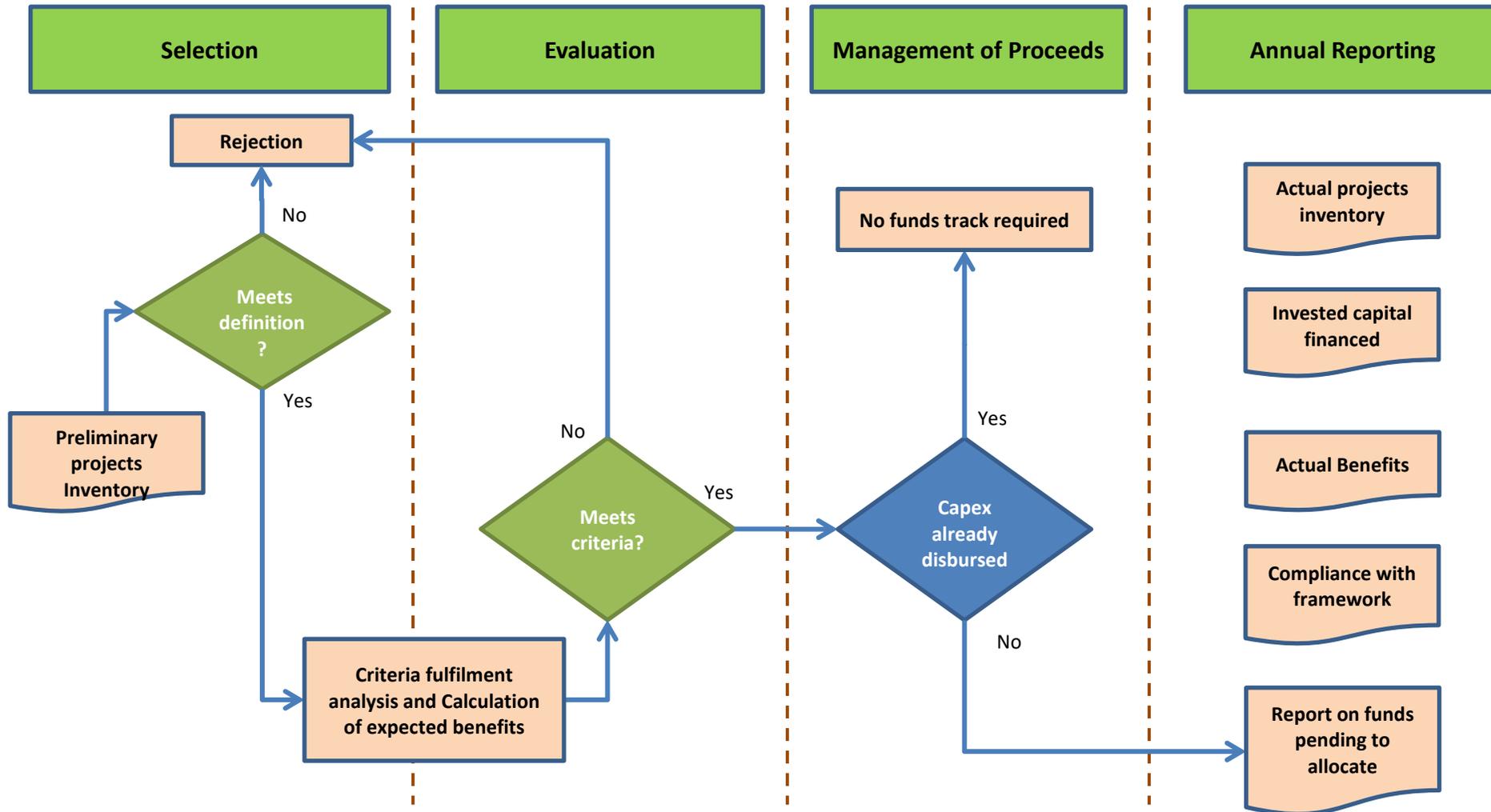
The Group's social responsibility strategy seeks to place it at the forefront of best practices in this area, convinced that these aspects are a fundamental part of its strategy of excellent and to improve its competitiveness, apart from being a basic component for fulfilling its corporate interest. The company considers Green Financing as a best practice.

The Company and the other companies of the Group carry out their business enterprise and their own business model with the objective of sustainably creating value for society, citizens, customers, shareholders, and for the communities in which they do business, providing a high-quality service through the use of environmentally-friendly energy sources, innovating and maintaining awareness of the opportunities offered by the knowledge economy.

Relevant documents can be found at following link:

<https://www.iberdrola.com/corporate-governance/corporate-governance-system/corporate-policies>

## 2. Annex: Selection and evaluation procedures



### 3. Annex: Summary of evaluation criteria

Code of criteria	Criteria	Commitment / Supporting documentation	Sustainability Development Goals	Area	Assurance Level
1	Promotion of equal opportunities	Measurement and analysis of women trend in workforce (Management team, Middle managers and skilled technicians)	5	Social Dimension	Corporate
2	Promotion of access to energy	Energy access implementation programs	7 and 1	Social Dimension	Corporate
3	Biodiversity	Approved biodiversity politics and biodiversity specific plan	7	Environment Protection	Corporate
4	Environmental management at design phase	Environmental Impact Assessment based on local regulation, and implementation of appropriate measures to limit, mitigate or compensate negative impacts (environmental specifications) covering at project lifecycle (from design to dismantling)	7	Environment Protection	Project
5	Environmental management at construction phase including Supply Chain	Environmental specifications adequately reflected in the contracts with suppliers	7	Environment Protection	Corporate / Project
6	Environmental management during operations	Project operated within an environmental management system implemented, audited, with targets, guidelines and appropriate monitoring to report (i.e. ISO 14001)	7	Environment Protection	Project
7	Environmental accidents prevention and control	Existence of accidental pollution emergency plans	7	Environment Protection	Project
8	Promote Sustainability practices amongst suppliers	Assessment of the significant suppliers' ESG performances	8	Long Term Value Creation	Corporate
9	Monitor procurement procedures acceptance and Sustainable procurement and Business Ethics	ISO 9001 certification of procurements procedures	8	Long Term Value Creation	Corporate

Code of criteria	Criteria	Commitment / Supporting documentation	Sustainability Development Goals	Area	Assurance Level
10	Quality of Health & Safety and Employment conditions	Safety risk assessment, implementation of appropriate measures for employees and contractors Existence of H&S monitoring indicators (i.e. Frequency index, Incidence index, Severity index) Training hours in prevention of occupational risk)	8	Social Dimension	Business Unit / Project
11	R&D Investment	R&D investment (MM eur)	9	Long Term Value Creation	Corporate
12	Sustainable local insertion	Dialogue with local stakeholders during construction and operational phases via monitoring and analysis of fines, penalties, procedures, arbitrations, complaints, etc.	11	Social Dimension	Project
13	Supporting local communities and their economies	Promotion of local purchases and/or local employment (expenditures on local suppliers)	11	Social Dimension	Corporate
14	Fight against climate change by producing clean energy	Contribution of the asset to avoid/reduce CO2 emissions	13	Environment Protection	Project
15	Environmental footprint	Elaboration of studies to improve understanding of environmental footprint	13	Environment Protection	Corporate / Business Unit
16	Carbon footprint	Reduction of emissions intensity (CO2/GWh) respect a base year	13	Environment Protection	Corporate
17	Increase awareness and knowledge on environmental aspects	Existence of environmental knowledge among all categories, based on the internal procedure of training and environmental profiles	15	Environment Protection	Corporate / Project
18	Protection of biodiversity	Mitigation or corrective actions implemented in case of biodiversity incident	15	Environment Protection	Project
19	Promotion of business ethics	Training plan that includes specific ethics programs	16	Long Term Value Creation	Corporate

Code of criteria	Criteria	Commitment / Supporting documentation	Sustainability Development Goals	Area	Assurance Level
20	Monitor internal and external respect for Human Rights	Existence of communication and complaint channels enabled in the Group and available for all Group professionals and suppliers	16	Social Dimension	Corporate
21	Training of employees on Human Rights	Training activities that include specific Human Rights aspects	16	Social Dimension	Corporate
22	Promotion of Human Rights	Adherence to UN Global Compact	16	Social Dimension	Corporate
23	Contribution to the respect of Human Rights	Inclusion of human rights clauses in the general conditions of Iberdrola contracts Existence of a human rights risk analysis in main activity countries (Spain, UK, USA, Brazil and Mexico)	16	Social Dimension	Corporate
24 <sup>7</sup>	Power density	In case of hydroelectric projects, measurement and achievement of a minimum power density ratio (W/m <sup>2</sup> ), ensuring that generation density is above a given threshold	13	Environment Protection	Project
25 <sup>8</sup>	Energy consumption CO <sub>2</sub> emissions	In case of hydro-pumping stations, measurement the CO <sub>2</sub> footprint of the consumed electricity, achieving a maximum threshold	15	Environment Protection	Project

<sup>7</sup> Just for hydroelectric projects.

<sup>8</sup> Just for hydro-pumping stations.