

NACIONAL FINANCIERA S.N.C. GREEN BOND

FRAMEWORK OVERVIEW AND SECOND-PARTY REVIEW BY SUSTAINALYTICS

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SUSTAINALYTICS

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1. PREFACE

Nacional Financiera, S.N.C, (“Nafin”) a Mexican development bank, has engaged Sustainalytics to review its Green Bond and provide an opinion. As part of this engagement, Sustainalytics, held conversations with Nafin’s treasury and sustainability teams to understand the use of proceeds, management of proceeds and reporting aspects of its Green Bond as well as sustainability strategy of Nafin. Sustainalytics also reviewed relevant public and internal documents and provided its opinion on the Green Bond. This document contains two sections: Framework Overview – summary of Nafin’s Green Bond framework; and Sustainalytics’ Opinion – an opinion on the framework.

2. INTRODUCTION

Nafin was created in 1934, to carry out important socio-economic transformations within the country. In the years that followed the opening of the Mexican economy, there was an increased challenge of modernization and structural change in the country’s industrial sector, therefore Nafin has worked to boost the competitiveness of the country’s enterprises. The development bank is responsible for promoting savings and investment through project management, establishing financing programs, coordination of investment capital and increasing economic productivity.

In 2009, in accordance with the commitments made by the Federal Government in the Special Climate Change Programme, Nafin, in its capacity as development bank, created the Sustainable Projects and Climate Change Unit within its International Division. At this time, Nafin started participating in projects related to the environment, particularly strategic renewable energy projects, with one single person.

Following this, in January 2010, Nafin strengthened the organizational structure aimed to attend renewable energy projects by formalizing the Sustainable Projects Direction within the Investment Banking Division. At this time, the Sustainable Projects department consisted of 3 people and became the first Mexican bank to grant funding to renewable energy projects, achieving an important position as an instrument of the federal government to cope with market failures, promote private sector participation, and support the meeting of environmental and social principles for sustainability projects¹.

It is worth mentioning that this program marks the return of Nafin to finance long-term projects in strategic sectors for economic development.

Currently, Nafin’s Sustainable Projects department consists of 15 people, including 4 external consultants hired with resources granted by the Inter-American Development Bank for programs focused on Sustainable Projects and Climate Change.

3. GREEN BOND FRAMEWORK OVERVIEW

Nafin is planning to issue a green bond the proceeds of which will be earmarked for projects within its renewable energy portfolio

¹ Financiamiento a Proyectos Sustentables, NAFIN , August 2015

3.1 Use of Proceeds

The proceeds of the Nafin first Green Bond are planned to be allocated to financing/funding eligible wind energy generation projects in Mexico.

3.1.1 Eligibility Criteria:

Activities generating energy from wind are eligible for the use of proceeds of the bond and will be the focus of Nafin's inaugural Green Bond. These activities specifically, refer to a) the development and construction of wind farms and/or b) wholly dedicated transmission infrastructure for wind farms.

Nafin plans to fund approximately USD 241 million new wind energy projects and about USD 336 million wind energy projects in the pipeline. Appendix A provides a detailed list of projects that could be allocated to the bond proceeds.

Eligible Projects means financing of, and/or investments in wind energy projects;

- a) committed after or before the issuance of the Notes; or
- b) are funded or disbursed after the issuance of the Notes; or
- c) are funded or disbursed during previous financial year.

3.2 Project Selection Process

Nafin's Sustainable Projects team actively seeks to develop Nafin's renewable energy portfolio and evaluates all loan applications for investment in sustainable projects through the following procedures.

3.2.1 Renewable energy classification

A project is first considered for funding by determining if it is a recognized renewable energy project regulated by the Use of Renewable Energy and Energy Transition Financing law², which states that the energy source must lie in natural phenomena, processes, or materials capable of being transformed into usable energy for humanity, regenerate naturally so they are available continuously or periodically, and therefore be one of the following types of energy sources:

- A. wind;
- B. solar radiation, in all its forms;
- C. the movement of water in natural or artificial channels;
- D. ocean energy in its various forms;
- E. heat from geothermal reservoirs;
- F. bioenergy, and
- G. those which, if any, determined by the Ministry of Energy (SENER), the source complies with the above paragraph.

In addition, NAFIN determines projects as eligible if they also comply fully with applicable national legislation, that is, any law, treaty, regulation, rule, order, statute, ordinance, order or judgment issued by a government authority in the field of, or that relates to the protection and conservation of the

² <http://www.diputados.gob.mx/LeyesBiblio/pdf/LAERFTE.pdf>

environment and the use and exploitation of natural resources as well as those governing the use, disposal, storage, disposal and overall management or environmental release of pollutants or hazardous materials, under which the project or its assets, are linked.

3.2.2 Due diligence

Nafin verifies the feasibility of any investment project by reviewing and analyzing the following due diligence reports:

Legal: Compliance with applicable laws, project agreements and land ownership status.

Technical: Estimation of energy production, project site conditions, review of project costs and construction schedule.

Insurance: Review of insurance during the construction and operational phases.

Financial: Review of the use of funds and the source of repayment during the financing.

Environmental and social: This is an important due diligence step carried out to determine whether the investment projects are sustainable by analyzing the social and environmental impact of the project. In this respect, Nafin follows the Equator Principles, which are a financial sector guideline used to identify, assess and manage environmental and social risks of projects. They are based on the Policy and Performance Standards on Social and Environmental Sustainability of the International Finance Corporation (IFC) and the World Bank General Guidelines on Environment, Health and Safety.

Equator Principles are applicable to the financing of new projects and significant expansions by four financial products: advisory on project financing, project financing, project-related corporate loans and bridge loans. Through adherence to these principles, Nafin commits to providing financing that meets the 10 Equator Principles. For a full list of the principles, please refer to Appendix B.

3.2.3 Projects selected for Green Bond

After carrying out the above renewable energy classification and due diligence steps, Nafin created its renewable energy loan book. From this loan book of eligible projects, Nafin will select projects that meet eligibility criteria mentioned above, for the allocation of bond proceeds.

3.3 Management of Proceeds

3.3.1 Management

Net proceeds arising from the issue of the bond will be allocated within Nafin's treasury liquidity portfolio and shall be used to fund, in whole or in part, the investments in Eligible Projects meeting the Eligibility Criteria.

Pending such disbursements, the net proceeds from the issue of the bond may be used for overnight investments and lending purposes, as well as in cash or other liquid marketable instruments. Nafin will monitor and account for net proceeds in order to ensure the allocation of such net proceeds for the investment in Eligible Projects meeting the Eligibility Criteria.

3.3.2 Tracking

To track compliance of borrowers, Nafin has established an internal area of supervision. Overall data on renewable energy finance transactions is also tracked and disclosed, including project type, amount invested, generating capacity, location, business line, and maturity. Each project is identified by an account number and all disbursements to that project will be tracked through this account. Nafin reports on such disbursements internally on a regular basis.

Eligible Projects means financing of, and/or investments in projects meeting the Eligibility Criteria: committed after or before the issuance of the bond, but funded or disbursed after the issuance of the bond, and/or funded or disbursed during previous financial year.

3.4 Reporting

Nafin will provide an annual report on the Use of Proceeds indicating the projects that were allocated from Green Bond proceeds, as well as the environmental outcomes of the Eligible Projects including estimated KWh of energy produced and the estimated greenhouse gases (GHG) emissions reductions or avoidance achieved. The report will include a breakdown of proceed allocations by category, by project, and by geographic location. This report will be made publically available on Nafin's website. For an example of a report estimated GHG emissions reductions please refer to Appendix C.

3.5 Compliance Review

Before the first anniversary of the Green Bond issuance, Nafin will engage Sustainalytics to review projects funded by the Green Bond in order to assess the compliance of projects with the use of proceeds criteria of the bond. Sustainalytics will review the projects in order to determine whether or not they meet the use of proceeds criteria defined in the framework. Sustainalytics will provide a report of the evaluation, which Nafin may plan to disclose publicly. In an unlikely event that a project did not meet the use of proceeds criteria, Nafin would reallocate the bond funds to a different project that is aligned with the criteria.

4 SUSTAINALYTICS' OPINION

Sustainable finance-focused organization

Nafin developed its sustainable finance program with the objective of promoting “environmentally friendly economic growth that allows companies to preserve natural resources while generating wealth, competitiveness, and employment.”

The program is available to national and international companies that promote the development of sustainable projects aimed towards ecological, economic, and social development. In addition, Nafin follows the Equator Principles, which ensures that funded projects have positive environmental and social impacts, and requires that each borrower is contractually obliged to provide reports that monitor the environmental and social aspects of funded projects.

Furthermore, Nafin has a dedicated sustainability team which shows commitment of the organization to support the financing of sustainable projects in Mexico. The above provides substantial evidence that Nafin is a sustainable-finance focused organization and therefore, in Sustainalytics' opinion, well positioned to issue this Green Bond.

Commitment to green finance

In 2015, Nafin became the only institution in Mexico to request accreditation to become a National Implementing Entity for the **Green Climate Fund (GCF)**. The GCF was created to achieve the ultimate objective of the United Nations Framework Convention on Climate Change (UNFCCC), to promote the paradigm shift towards low-emission and climate-resilient development pathways by providing support to developing countries to limit or reduce their greenhouse gas emissions and to adapt to the impacts of climate change.³

Nafin has also worked closely with relevant stakeholders, including the Inter-American Development Bank, the United Nations Economic Commission for Latin America and the Caribbean (ECLAC) and the Latin American Association of Development Financing Institution (ALIDE) to design a workshop to understand how national development banks can best access green funds, develop a portfolio of projects, and strengthen institutional capacities in this area. Although Nafin is still working towards its accreditation, these actions demonstrate a commitment to the Green Climate Fund and addressing the impacts of climate change, which aligns well with the desired objectives of the Green Bond.

Relevance of renewable energy growth in Mexico and Nafin's role

According to a 2015 report by the International Renewable Energy Agency and the Mexican Energy Secretariat, Mexico currently represents one-fifth of all energy use in Latin America and the Caribbean region, and is therefore, is key to ensuring a successful regional transition to renewable energy.⁴

The report also outlines that Mexico has the potential to generate 280 TWh of renewable power by 2030, representing a six fold increase over today's level of 48 TWh. This would lead to considerable positive

³ <http://www.gcfund.org/about/the-fund.html>

⁴ http://www.irena.org/DocumentDownloads/Publications/IRENA_REmap_Mexico_report_2015.pdf pg. 2

environmental and societal impacts, such as reduced health costs related to GHG emissions. However, achieving this would require a diversified mix of wind, solar, hydro, geothermal, and biomass power technologies.⁵

Nafin has been investing in renewable energy projects in Mexico since 2009 and is an active promoter of the country's renewable energy transition. As of June 30, 2015, the portfolio of sustainable project loans amounted to 6,363 million pesos, including financing for the construction and operation of nine wind farms (5,308 million pesos), one solar photovoltaic farm (523 million pesos) and one mini hydro plant (532 million pesos).

Proceeds from Nafin's Green Bond will be used to fund wind energy projects across several Mexican states, helping to increase Mexico's renewable energy mix and moving the country towards a sustainable energy future. Therefore, this bond has significant potential to create a positive environmental impact in Mexico.

Transparent reporting aligned with best practice

Nafin has committed to detailed annual public reporting of its Green Bond proceeds allocation and the estimated GHG emissions reductions that correspond to funded projects, Sustainalytics believes this demonstrates a commitment to transparency to investors and is aligned with market best practices. In addition, having a compliance review post issuance to assess the alignment of funds to eligible projects will provide additional transparency with regard to the Green Bond.

Conclusion

Nafin is well positioned to issue this Green Bond, as the organization has demonstrated a strong commitment to sustainable finance over the last ten years. Nafin's reporting on the allocation of Green Bond proceeds will be detailed and transparent, which will provide investors clarity on the estimated GHG emission reductions achieved. In addition, Nafin has engaged Sustainalytics to conduct a compliance review before the first anniversary of the bond, which will provide additional assurance that the bond is fully compliant with the use of proceeds criteria.

According to estimates by the Mexican Energy Secretariat (SENER) carrying out the 2015-2029 National Electricity System Development Program initiative will require reaching almost 60,000 MW of additional generation capacity over the next 15 years to meet expected demands.⁶ Mexico has substantial renewable energy resources, such as wind, solar, and geothermal, that can be developed to help reach this required energy demand, in a way that does not negatively affect the environment and society. The wind energy projects developed with proceeds from Nafin's Green Bond will play a role in transitioning Mexico towards a more sustainable energy sector.

Nafin's Green Bond follows the guidance provided by the Green Bond Principles 2015 and is in alignment with its four components – the use of proceeds, process of project evaluation and selection, management of proceeds and reporting. Nafin's Green Bond has also been certified under the [Climate Bond Standard](#),

⁵ http://www.irena.org/DocumentDownloads/Publications/IRENA_REmap_Mexico_report_2015.pdf pg. 3

⁶ http://www.energia.gob.mx/res/index/PRODESEN%202015_2029.pdf pg.39

becoming only the fifth green bond to receive this certification, and the first in the Americas. Sustainalytics considers Nafin's Green Bond to be robust, credible, and effective in reducing the GHG emissions by financing wind energy projects.

APPENDICES

Appendix A: List of existing and potential projects for bond proceeds allocation

Nafin Green Bond Projects

Amounts as of June 2015

Figures in million dollars

	Project	Size	Location	Date amount financed	Amount outstanding at Sep-15	Amount expected at Dec-16	Status	Energy Production kWh/year
Existing Projects	Multinational funding of wind park	396 MW	OAXACA	September, 2015	16.94	51.50	Fully Funded	1,012,936
	Multinational funding of wind park		OAXACA	September, 2015	0.00	20.85	In restructuring	
	Wind Farm		OAXACA	September, 2015	0.00	17.84	In restructuring	
	Wind Farm	137.5 MW	OAXACA	September, 2015	27.08	24.16	Fully Funded	492,641
	Wind Farm	160 MW	OAXACA	September, 2015	43.82	42.22	Fully Funded	553,632
	Wind Farm	126 MW	NUEVO LEON	September, 2015	15.62	23.71	Disbursing	401,769
	Wind Farm	126 MW	NUEVO LEON	September, 2015	15.29	23.09	Disbursing	401,769
	Wind Farm	155.1 MW	OAXACA	September, 2015	38.38	37.86	Fully Funded	345,104
Total Existing Renewable Energy Projects					157.13	241.22		

	Project	Size	Location	Date amount financed	Amount outstanding at Sep-15	Amount expected at Dec-16	Estatus	Energy Production kWh/año
Proposed	Wind Farm	200 MW	COAHUILA	December, 2015	0.00	102.00	Next Closing	655,248
	Wind Farm	130 MW	ZACATACAS	December, 2015	0.00	75.00	Next Closing	334,807
	Wind Farm	66 MW	PUEBLA	December, 2015	0.00	69.88	Next Closing	202,356
	Wind Farm	99 MW	SONORA	December, 2015	0.00	89.06	In negotiation	294,862
Total Proposed Renewable Energy Projects					0.00	335.94		

Appendix B: Equator Principles⁷

Principle		Description
1	Review and Categorization	The project to be funded should be categorized according to the magnitude of the potential environmental and social risks and impacts defined by the IFC for due diligence.
2	Social and Environmental Assessment	Social and environmental aspects of the project will be evaluated and, where appropriate, management or mitigation plans for identified impacts will be proposed.
3	Applicable Social and Environmental Standards	The assessment process should, in the first instance, address compliance with relevant host country laws, regulations and permits that pertain to environmental and social issues.
4	Action Plan and Management System	The borrower will prepare an action plan to manage the findings identified in the evaluation stage.
5	Dissemination and Consultation	The borrower will consult affected communities located in the area of influence of the project in a structured and culturally appropriate manner.
6	Grievance Mechanism	To ensure the dissemination, consultation and community relations will continue throughout the construction and operation, a grievance mechanism will be established to receive and facilitate resolution of concerns and grievances about the project's environmental and social performance.
7	Independent Review	An independent environmental and social consultant, not directly associated with the client, will carry out an independent review of the assessment documentation in order to assist the Equator Principles due diligence.
8	Guarantees	For all projects, the borrower will covenant in the financing documentation to comply with all relevant host country environmental and social laws, regulations and permits in all material respects.
9	Independent Monitoring and Reporting	An external expert will assess project compliance with the Equator Principles and will ensure ongoing monitoring and reporting after financial close and over the life of the loan.
10	Report of Financial Institution	The financial institution will report publicly, at least annually, on transactions that have reached financial close and on its Equator Principles implementation processes and experience, taking into account appropriate confidentiality considerations.

⁷ http://www.equator-principles.com/resources/equator_principles_III.pdf

Appendix C: Reporting example of estimated GHG emissions reductions achieved and calculation used

Project	Location	Capacity	Load Factor	Energy Production	Emission Factor	Reduction of Greenhouse Gases
		MW	P-90	MWh/año	2013	Ton CO2
Wind Farm 1	Oaxaca	250.5	38.8%	851,419	0.4999	425,625
Wind Farm 2	Oaxaca	90.0	37.8%	298,015	0.4999	148,978
Wind Farm 4	Oaxaca	164.0	35.4%	508,571	0.4999	254,234
Wind Farm 5	Oaxaca	160.0	39.5%	553,632	0.4999	276,761
Wind Farm 6	Oaxaca	137.5	40.9%	492,641	0.4999	246,271
Wind Farm 7	Baja California	155.1	25.4%	345,104	0.4999	172,517
Operating:		957.1		3,049,381.4		1,524,385.8
Wind Farm 3	Oaxaca	396.0	29.2%	1,012,936	0.4999	506,367
Wind Farm 8	Nuevo León	126.0	36.4%	401,769	0.4999	200,844
Wind Farm 9	Nuevo León	126.0	36.4%	401,769	0.4999	200,844
Construction:		648.0		1,816,473.6		908,055.2
TOTAL		1,605.1		4,865,855		2,432,441

To calculate the impact of the reduction of greenhouse gas emissions for the Sustainable Projects portfolio, the following formula will be used:

$$tCO_2 = \frac{EAEP \times EEF}{1,000}$$

Where,

EAEP = Estimate Annual Electricity Production

EEF= Estimate Annual Electricity Factor (tCO₂/MWh)

tCO₂ = Tons of carbon dioxide

MWh= Megawatt hour

The electric emission factor serves as an estimate on the discharge of greenhouse gases caused by the purchase of energy in the country. This factor varies every year, subject to the fuel consumption mix used to generate electricity; only the energy distributed and transmitted by the Nacional Electricity System is taken into account. In this matter, the emission factors are statistical averages calculated based on greenhouse emissions measured by the activity of a specific production source.

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