

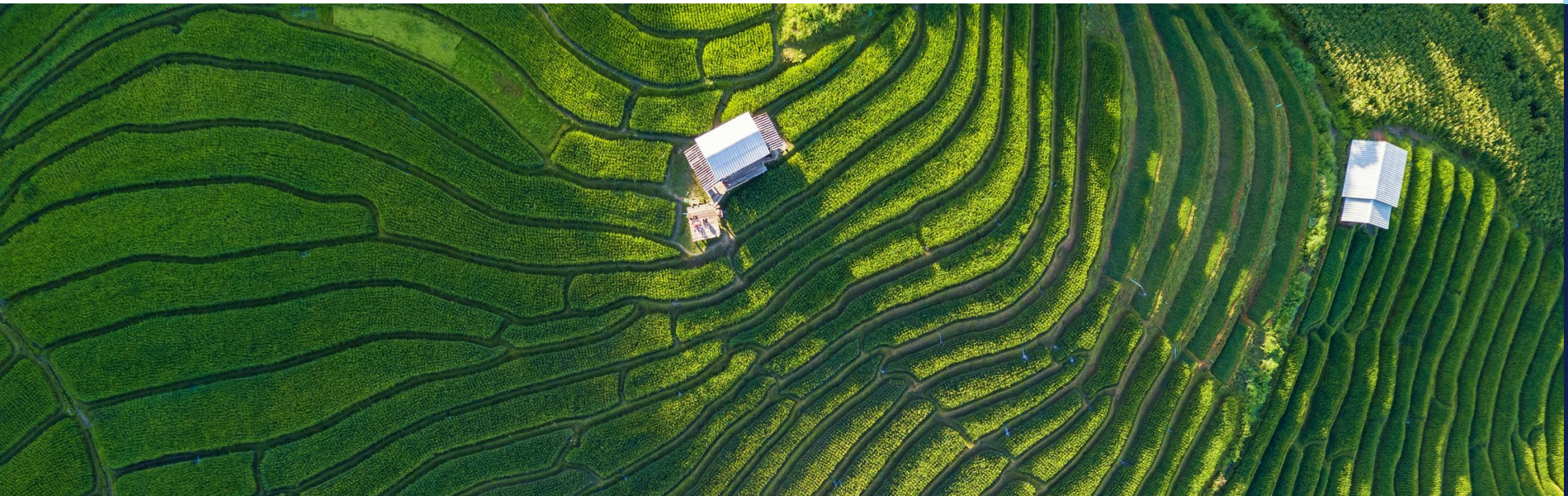


WHEN TRUST MATTERS

Internal Assessment for Midland Heart's Sustainable Finance Framework 2023

Prepared by DNV Business Assurance Services UK for Midland Heart

29 January 2024



We are DNV

DNV helps businesses manage risk and assure the performance of their organisations, products, people, facilities and supply chains through certification, verification, assessment and training services.

We combine technical, digital and industry expertise to empower companies' decisions and actions.

Partnering with our customers, we build sustainable business performance and create stakeholder trust across all types of industries. With origins stretching back to 1864 and operations in more than 100 countries, our experts are dedicated to helping customers make the world safer, smarter and greener.

Our Purpose

To safeguard life, property, and the environment.

Our Vision

A trusted voice to tackle global transformations.

Our Values

We care. We dare. We share.



WE CARE



WE DARE



WE SHARE

1864

Year founded

Oslo

Head office

100+

Countries

300

Offices globally

13,000

Professionals

£1.9bn

2022 revenue



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1. Overview of the Internal Quality Assessment

Scope of the Internal Quality Assessment

This Internal Assessment is a review of Midland Heart's processes and systems against the requirements set out in their 2023 Sustainable Finance Framework. This internal assessment will help the company with its future issuances. DNV provided Midland Heart with a Second Party Opinion (SPO) on the Framework and were satisfied that the commitments outlined are aligned with the ICMA's Green Bond Principles 2021 with 2022 Appendix (GBP), Social Bond Principles 2023 (SBP) and Sustainability Bond Guidelines 2021 (SBG) as well as the LMAs Green Loan Principles 2023 (GLP) and Social Loan Principles 2023 (SLP). The ultimate output of this assessment is to ensure those commitments can now be met by Midland Heart.

The assessment primarily reviewed Midland Heart's processes, committee Terms of References, treasury management, reporting, and Use of Proceeds analysis to understand Midland Heart's current position and to identify any gaps that may exist.

This Internal Assessment is only advisory.

The purpose of this report is to inform Midland Heart of the commitments that have been made, the processes Midland Heart needs to have in place, and how Midland Heart can position itself most effectively about its future bond issuances or loans as well as being in a strong position to obtain independent assurance.

Internal Assessment project steps



The assessment was limited to the review of reporting and disclosure requirements of Midland Heart's Sustainable Finance Framework

Benefits of Internal Assessment before Independent Assurance

- ✓ Helps build confidence in your data for internal decision-making processes
- ✓ De-risk the Independent Assurance process by receiving a qualified assurance opinion
- ✓ Introduction of the assurance process to data owners and Midland Heart management
- ✓ Our Internal Quality Assessment Report will identify any gaps with time for Midland Heart to address these before the 2023 Independent Assurance process begins.

Final deliverables

Final deliverables (this document)



Internal Assessment Report (confidential for internal use)

We have prepared this concise Internal Assessment Report, outlining:

- High level **strategic observations**, highlighting general strengths, relevance and gaps with current allocation plans and reporting; and
- More **detailed findings** to help improve its processes and procedures for increasingly robust data collection and calculation.

This feedback will help you make improvements to ensure you continue to produce robust data and reporting in subsequent reporting cycles.

To conduct the engagement, we will need Midland Heart to provide the following upon project kick-off:

Basis of Reporting



An explanation of your reporting calculation methodology, scope and measurement. We will use this Basis of Reporting as the “Criteria” for the Internal Quality Assessment.

Internal Processes for Allocation

An explanation of how you currently align with the framework as per the allocation commitments. We will use this Basis of Allocation as the “Criteria” for the Internal Quality Assessment.

Our approach

The Internal Quality Assessment considered the following aspects of Midland Heart's data and processes:

Aspect	Questions covered
Definitions	Is there a clear and unambiguous definition of the process and/or the metric?
Source	What is the original source of any of the information/data?
Boundaries and scope	What parts of the business are covered by the commitments? Are there any exclusions?
Reporting period	What period does the framework and other associated documents cover?
Protocols and calculation	Are any external protocols or standards followed to compile and present the data?
Classification	Is the data classified into different categories?
Controls and validation	What controls are in place to ensure the information gathered is accurate and reliable? What is the validation and sign-off process?



Classification of our observations and recommendations

This Internal Quality Assessment Report summarises the observations and recommendations identified during the course of DNV’s Internal Quality Assessment.

Each observation and recommendation has been classified by priority to allow Midland Heart to plan and prepare impending issuances on the framework and obtaining subsequent Independent Assurance at year-end reporting.

Priority	Definition
Positive	Positive observation, no action required.
Action	An action is required to fully be in compliance with the Framework. It is immaterial and a simple process to fix
Action	An urgent action is needed to be in compliance with the Framework. It is something which must be in place and is not currently part of the process.

This Report is advisory. It is confidential and for internal use only.

Midland Heart’s management should review the observations and recommendations made and consider the necessary implications for implementing the recommendations. Our recommendations are suggestions for ways to address the observations and risks. Alternative approaches may also be appropriate.



Principle 1 – Use of Proceeds

1. Use of Proceeds

Ref	Requirements	Midland Heart's Current position	DNV's recommendations	Status
1a	Investing in projects that support environmentally and socially sustainable outcomes for the benefit of society, the environment and identified target populations.	Midland Heart built a Use of Proceeds table which outlined their method for defining Green and Social definition for their financing.	We recommend prioritizing investments in projects that promote either/both environmental and social sustainability. By focusing on initiatives that benefit society, the environment, and specific target populations, engaging in projects that promote environmental and social sustainability is advisable for overall societal well-being and ecological health. This strategic investment aligns with ethical considerations and positively impacts targeted communities. In providing a positive Second Party Opinion, DNV are confident in the Green and/or Social credentials that the framework outlines	Positive
1b	An amount equivalent to the net proceeds will be used to finance and/or refinance in whole or in part new or existing Eligible Projects.	Midland Heart has made this commitment in its framework and Senior Treasury Management are aware of the kinds of finance for which projects are eligible.	We recommend following: <ul style="list-style-type: none"> Define the purpose and the scope: Allocate funds matching net proceeds to finance or refinance Eligible Projects and specify whether the funds support new or existing projects, ensuring clarity. Promote accountability: Provide details on the nature of Eligible Projects for greater transparency. Foster clarity: Articulate how funds will be used to avoid ambiguity and enhance stakeholder understanding. 	Positive
1c	Dependent on the nature of the project, the investment in Eligible Projects can be measured through asset value, capital expenditure ("Capex") or operating expenditure ("Opex"). For capital or operating expenditures, a look-back period of up to 24 months prior to the time of debt issuance will be applied.	Midland Heart has made this commitment in its framework and Senior Treasury Management are aware of the types of expenditure under which projects are eligible.	We recommend assessing the investment in Eligible Projects based on their nature, utilising metrics such as asset value, capital expenditure (Capex), or operating expenditure (Opex). A look-back period of up to 24 months before the time of debt issuance for both capital and operating expenditures is to be implemented. This approach ensures a comprehensive evaluation of the project's financial dynamics, enhancing the precision of investment decisions and fostering a more informed and strategic investment strategy.	Positive
1d	Allocate an amount equivalent to the net proceeds raised by any sustainably labelled debt instruments to Eligible Projects within 36 months of issuance.	Midland Heart has made this commitment in its framework and Senior Treasury Management are aware of the timescale of an investment or a project to be eligible under the framework	By adhering to this allocation timeline, Midland Heart are able to optimise the impact of investments, contributing to positive environmental and social outcomes while maintaining transparency and accountability in financial strategies.	Positive

Principle 2 – Process for Project Evaluation and Selection

2i- Excel sheet overview

2. Process for Project Evaluation and Selection

Ref	Requirements	Midland Heart's Current position	DNV's recommendations	Status
2a	The New Business Group is accountable for the selection and evaluation of projects using guidelines approved by the ESG Committee.	<p>Midland Heart has set up the New Business Group and has a comprehensive Terms of Reference.</p> <p>Section 3.2 outlines the role of the New Business Group with regard to labelling projects.</p>	<p>Midland Heart should include text which includes the role of the New Business Group with regards to Sustainable Financing. The framework explains that the New Business Group will select projects and propose allocation to a Green/Social/Sustainable Finance instrument, be that for financing or refinancing.</p> <p>DNV suggests extending 3.2 to cover this.</p>	Action
2b	Overall accountability for the framework will sit with the ESG Committee who is responsible for the coordination, evaluation, and general organisation, of the progress against the pledges and obligations detailed within the framework on behalf of Midland Heart.	The committee has 6 specific responsibilities with regards ESG policy across the company. These include development and execution of ESG plans, periodic reporting, monitoring of ESG related risks and report approval.	<p>Midland Heart should include another responsibility to outline the role the ESG committee will play with regards to Midland Hearts sustainable financing.</p> <p>DNV suggests adding 2.7.</p> <p>This should read that the ESG committee has the responsibility of the Sustainable Finance Framework and the obligations therein with exception of the selection and evaluation of projects which sits under the New Business Group.</p>	Action
2c	The Committee is chaired by Midland Heart's Executive Director of Finance & Growth and includes two other Executive Directors, Executive Director of Operations and Executive Director of Corporate Resources. Other participants may include senior leadership and subject matter experts from Directorates.	<p>The committee is chaired by the Executive Director of Finance and Growth.</p> <p>Membership also includes: Executive Director of Operations, Executive Director of Corporate Resources, Director of Talent & Communications, Director of Development, Director of Strategic Planning & Performance, Director of Housing, Director of Building Safety, Director of Portfolio Management and Service Improvement, Director of Assets, Director of Finance & Treasury, Director of Human Resources Operations, Director of Governance, Head of Safety & Facilities, Head of Procurement and a Partner representative</p>	<p>None.</p> <p>This is aligned with your framework and the additional membership is in place.</p>	Positive

2. Process for Project Evaluation and Selection

Ref	Requirements	Midland Heart's Current position	DNV's recommendations	Status
2d	Projects and programmes coordinated and evaluated within the ESG Committee may ultimately be reportable to Board as determined by the strategic focus of the workstream, for example: energy efficiency measures that will achieve EPC uplifts within the homes Midland Heart rents.	There is no confirmation within the documents, and it is assumed this is the case.	<p>We recommend that the ESG Committee should ensure that projects and programs are thoroughly coordinated and evaluated. Strong Governance suggests that the Committee should determine which outcomes are reportable to the Board. The two primary reasons include the showcasing of Sustainable Finance as a key financial and strategic aim of Midland Heart as well as the size of the potential portfolio of transactions potentially eligible.</p> <p>It is the responsibility of the New Business Group to review all of the proposed Use of Proceeds as currently set out in the Excel file sent by Midland Heart. DNV has had a high-level review (see here) and no red flags were raised, though this is not a substitute for the process outlined in the Framework.</p>	Action
2e	Where relevant, mitigation will be developed to address any possible negative material social and/or environmental risks associated with eligible projects.	The Framework covers this, there is no reference to this in other documentation	While this does not exist in the General Terms of Reference for either the New Business Group nor the ESG committee. This kind of information regarding the process by which the respective committee/group will operate during their agenda item is not a requirement, nor something DNV feels more information is required on.	Positive
2f	Escalation of the reporting process will be made in a timely manner to the Board where material risks have been identified.	Midland Heart has confirmed this is the case.	It is strongly advised to promptly escalate the reporting process to the Board whenever material risks are identified. This ensures timely communication and allows the Board to effectively address and mitigate any potential issues. Swift escalation is crucial in maintaining transparency and enabling proactive decision-making by the Board in response to significant risks. Also, we recommended to establish clear protocols and timeframes for such escalations to ensure effective communication and prompt decision-making in response to emerging risks.	Positive

2i. Process for Project Evaluation and Selection (Review of the Excel sheet for EPC Allocations)

Until the scope is finalised, DNV cannot fully confirm whether the data is assure-able, though with the information we currently have, we could make an informal assessment. Please note this is only advisory.

Ref	Key Requirements	Midland Heart's Current position	DNV's recommendations	Status
2ia	Data Specificity	The Excel sheet provides clearly precise data mapped to each property, where it is relevant. This is	Additional data points may be required for varying scopes. Keep invoices tracked and maintain evidence for all the claims and assertions made, where this is possible.	Positive
2ib	EPC Changes	The Excel sheet provides EPC data, both past and present and evidences it with Government EPC sources	<p>Given the improvement of EPC ratings is a key Use of Proceeds that the framework includes. improvement of EPC ratings, it is very positive to see you have been able to track historic and current EPC ratings which have been evidenced.</p> <p>DNV recommendation: the Framework includes an EPC uplift to a minimum of C to be eligible. When allocating to a Green Asset portfolio, ensure those measures to comply with these criteria are in place. For example, an improvement from E to D is not eligible, so make sure the filters are clear.</p>	Positive
2ic	Eligible and Non-eligible amounts	The Excel sheet tracks expenditure on the relevant properties, and includes a column on the eligible amount and non-eligible amounts.	Midland Heart do well to provide a breakdown of eligible and non-eligible expenditures. This is helpful as the framework provides high-level wording: "Installation of appliances or devices to improve energy efficiency of new or existing homes" – detailing these expenditures gives confidence of the green credentials underpinning the category.	Positive

2ii. Process for Project Evaluation and Selection (Review of the methodologies)

Until the scope is finalised, DNV cannot fully confirm whether the data is assure-able, though with the information we currently have, we could make an informal assessment. Please note this is only advisory.

Ref	Key Requirements	Midland Heart's Current position	DNV's recommendations	Status
2iia	Traceability of the finance	<p>The total summed amount is £97m. This is split across three UOP Categories:</p> <ul style="list-style-type: none"> - Renewable Energy - Energy Efficiency - Affordable Housing <p>Each across EPC cash flow and the EPC data</p>	<p>Based upon the calculations and methodologies used, it is clear how the £97m due to be allocated is divided. If DNV were to undertake future assurance, DNV would request evidence of the specific amounts (as samples).</p> <p>For each expenditure item, the total amounts, its position in allocation and the calculation towards the ultimate Sustainable Financing amount appears appropriate.</p> <p>The categories Renewable Energy, Energy Efficiency and Affordable Housing all appear in the Sustainable Finance Framework and as such are included.</p>	Positive
2iib	Traceability of underlying cases	<p>Midland Heart has inputted the total for each property or series of properties and then used Excel functions to populate final figures, bringing it to the final amount of £97m.</p> <p>This methodology is clear on EPC – Cashflow (Affordable Housing) and EPC Data (Renewable Energy and Energy Efficiency)</p>	<p>EPC-Cashflow does lack some clarity based on the information currently available to us. For example, it is unclear for Row 20 on EPC-Cashflow how the £298,367 was confirmed. It has been calculated by the £348,441 total and multiplied by 10/12 as 10 properties reach a B minimum and 2 do not. While it is possible that this figure may be correct, it does assume each underlying property has exactly the same expenditure on it.</p> <p>Those areas are already highlighted in yellow showing they are special cases.</p> <p>DNV would suggest being more specific with the amounts that are EPC B+ and those that are not, as an equal distribution of funds has been assumed.</p> <p>Were DNV to be assuring, we would request to see these invoices as evidence for the total amounts.</p>	Unclear

Principle 3 – Management of Proceeds

3. Management of Proceeds

Ref	Requirements	Midland Heart's Current position	DNV's recommendations	Status
3a	Midland Heart's aim is to be transparent and net proceeds from the applicable funding instrument will be appropriately segregated and tracked by the Finance Team and ESG Committee and reconciled to the disclosed Eligible Project(s) as referenced under this framework.	All funds are included within the same corporate account. They are monitored and tracked separately.	<p>In the framework, Midland Heart commits to segregating funds as well as the tracking through the Finance Team and ESG committee. This is best market practice and provides clarity to any lender or investor that their funds are being appropriately tracked.</p> <p>DNV would suggest that for Midland Heart's future Sustainable Financing, separate accounts or funds storage facilities are made. If this is not possible or too practically difficult, then to have clear separation in the accounting, with trackers or spreadsheets</p>	Action
3b	The Finance Team, which includes the corporate and commercial aspects of the management of accounts and planning, has overall responsibility for tracking and reporting.	Midland Heart has confirmed this is the case and that the proceeds from any Sustainable instrument will be monitored by the specialist finance team.	Regular review and refinement of reporting processes can enhance accuracy and transparency, contributing to informed decision-making when assessing the appropriate allocations.	Positive
3c	Where the funding instrument is a Bond, Private Placement or Term Loan, Midland Heart intend to fully allocate the proceeds to eligible projects within 36 months of receipt.	This is a commitment made within the Framework to be implemented by Midland Heart at receipt of funds.	DNV sees no reason this cannot be implemented efficiently, though do make sure the dates of all projects are clear to have an accurate account of what qualifies under the lookback period.	Positive
3d	Whilst it is intention to raise finance for new projects, Midland Heart may need to use the proceeds for refinancing activity and the framework supports this.	This is a commitment made within the Framework to be implemented by Midland Heart upon learning about new or existing projects.	We recommend endorsing the statement as it clearly articulates Midland Heart's intention to secure financing for new projects. The Framework enables both forms of financing which allows for adaptation to changing financial needs. Overall, the statement demonstrates a strategic and adaptive approach to financing that helps with the long-term sustainability.	Positive

3. Management of Proceeds

Ref	Requirements	Midland Heart's Current position	DNV's recommendations	Status
3e	Where appropriate, Midland Heart commit to provide an estimate of the share of new financing versus re-financing at the time of engagement.	While not having undertaken an issuance under a Sustainable Finance label, Midland Heart has committed to providing a % of all of their respective issuances.	We do not typically see issuers struggling with this aspect, though it does require tracking of each asset, as Midland Heart looks like it has done with the Excel file shared. A key element of ensuring the appropriate label is applied is the tracking of dates of finance and the dates of asset purchase.	Positive
3f	Where Midland Heart elect to re-allocate and assign proceeds to existing eligible projects, Midland Heart intend to look back no more than 24 months from the appropriate receipt of proceeds.	While not having undertaken an issuance under a Sustainable Finance label, Midland Heart has committed to a maximum lookback of 24 months.	We do not typically see issuers struggling with this aspect, though it does require tracking of each asset, as Midland Heart looks like it has done with the Excel file shared. A key element of ensuring the appropriate label is applied is the tracking of dates of finance and the dates of asset purchase.	Positive
3g	Pending the full allocation of proceeds to eligible projects, the balance will be invested in cash or short-term liquidity money market instruments in accordance with Treasury Management Policy or used to optimise overall debt position pending allocation to Eligible Projects.	Midland Heart has a Treasury Management Policy which aligns with the ICMA and LMA principles, as DNV outlined in the SPO.	So long as this is complied with, and DNV sees no reason it would not be, there is no substantial action on Midland Heart.	Positive

Principle 4 – Reporting

4. Reporting

Ref	Requirements	Midland Heart's Current position	DNV's recommendations	Status
4a	<p>The Reporting to include:</p> <ul style="list-style-type: none"> The amount of net proceeds allocated to each Eligible Project ("Allocation Reporting"); 	<p>Midland Heart is currently using open accounts as the basis for the invoice. Midland Heart has also built a spreadsheet which shows each of the transactions potentially eligible under the definitions as outlined by the Framework.</p>	<p>We do not typically see issuers struggling with this aspect, though it does require tracking of each asset, as Midland Heart looks like it has done with the Excel file shared. A key element of ensuring the appropriate label is applied is the tracking of dates of finance and the dates of asset purchase.</p>	Positive
4b	<p>The Reporting to include:</p> <ul style="list-style-type: none"> Expected key performance indicators ("KPIs") (qualitative and/quantitative environmental indicators) where feasible ("Impact Reporting") 	<p>Midland Heart in its framework outlined a list of indicative impact metrics for each Use of Proceeds category.</p>	<p>The impact metrics Midland Heart outlined in its Framework are only indicative. Some impact metrics used may not be used, while there are some additional impact metrics Midland Heart may wish to use at a later date.</p> <p>DNV would recommend receiving a Second Party Opinion on a transaction if there are any changes to the impact metrics, ahead of the issuance. DNV is best able to advise closer to the time, depending on scope.</p> <p>DNV would recommend receiving external assurance on a transaction, within one year on any bond or loan issued. DNV is best able to advise closer to the time, depending on scope.</p>	Positive
4c	<p>The reporting for the above to be published:</p> <ul style="list-style-type: none"> On an annual basis On the website for allocation reporting and within the ESG report for impact reporting 	<p>Midland Heart has clearly outlined its indicative allocation and has provided a list of impact metrics. The use of both can provide the expected impact of the finance.</p>	<p>The spreadsheet shared by Midland Heart as well as the impact metrics outlined in the Framework provides the underlying data to calculate the allocations and the impact.</p> <p>It is the subsequent duty of Midland Heart to publish their Green issuances' impact and allocation as per the framework to merit the Sustainable label.</p> <p>Upon determining a scope for assurance after issuance, this can be discussed further.</p>	Positive

Our vision: A trusted voice to tackle global transformations



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