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Second Party Opinion

Baltic Horizon Fund Sustainability-Linked Bond Framework

March 30, 2023

Baltic Horizon Fund (BHF), owned and managed by Northern Horizon Capital AS, is a regulated investment fund registered in Estonia in 2016. It manages a diversified portfolio of 15 retail and office assets. BHF is supervised by the Estonian Financial Supervision and Resolution Authority and is listed as a fund on the Nasdaq Tallinn Stock Exchange. Under the EU's Sustainability Finance Disclosure Regulation (SDFR), BHF is categorized as a light green fund under Article 8, implying that the companies in which it invests follow good governance practices and that it promotes environmental or social characteristics, among others, in its investments.

In our view, Baltic Horizon Fund's Sustainability-Linked Bond Framework, published on March 30, 2023, is aligned with:

 Sustainability-Linked Bond Principles (SLBP), ICMA, 2020

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Issuer's Sustainability Objectives

Northern Horizon Capital and all its managed funds, including BHF (the group), intend to contribute to the goals set out in the Paris Agreement, which aims to limit global warming to 1.5°C compared with pre-industrial temperatures. To do so, the group has established a target of reaching net zero for its carbon emissions by 2030. BHF is committed to improving energy efficiency and reducing the carbon footprint of its portfolio to contribute to the group's net zero target. In this regard, the fund aims to increase the use of renewable electricity within its portfolio, and to reach and maintain a high evaluation against the Global ESG Benchmark for Real Assets (GRESB).

As part of its ESG strategy, BHF works closely with tenants to promote sustainability practices and uses stakeholder engagement activities to get involved in the communities where it is present. The fund decided to develop its sustainability-linked bond framework to align its value proposition with its funding strategy and, in this way, achieve its sustainability ambitions.

Selected Key Performance Indicator (KPI) And Sustainability Performance Target (SPT)

KPI	SPT	Baseline	2021 performance
Renewable electricity consumption in the portfolio (kWh by percentage of gross area)	By May 30, 2025, at least 80% of the portfolio by gross area shall use renewable electricity	42% (2021)	42%

Second Party Opinion Summary

Selection of key performance indicators (KPIs)

Alignment  Baltic Horizon Fund’s Sustainability-Linked Bond Framework is aligned with this component of the SLBP.

KPI Renewable electricity consumption in the portfolio (kWh by percentage of gross area) Not aligned **Aligned** Strong Advanced

Calibration of sustainability performance targets (SPTs)

Alignment  Baltic Horizon Fund’s Sustainability-Linked Bond Framework is aligned with this component of the SLBP.

SPT By May 30, 2025, at least 80% of the portfolio by gross area shall use renewable electricity Not aligned **Aligned** Strong Advanced

Instrument characteristics

Alignment  Baltic Horizon Fund’s Sustainability-Linked Bond Framework is aligned with this component of the SLBP.

The framework specifies that if the SPT is not met by the target observation date, the interest rate will be adjusted upward by 50 basis points (bps) a year, from the interest period that includes the target observation date, until the bond matures, and that this will be stipulated in the documentation for the specific bond.

The framework also includes a fallback mechanism under which, if the issuer fails to publish its final sustainability performance report, or to calculate SPT for the final sustainability report, the interest rate will be adjusted upward by 50 bps a year. The increase will be applied from the interest period that includes the interest rate step-up date, until the date when the final Sustainability Performance Report is published or the final redemption date, whichever is sooner.

Reporting

Alignment  Baltic Horizon Fund’s Sustainability-Linked Bond Framework is aligned with this component of the SLBP.

Score Not aligned Aligned **Strong** Advanced

The issuer commits to publishing an annual sustainability performance report on its website, within 90 days of the end of the financial year. The report will include any updates relevant to the analysis of the target, to enable investors to monitor performance against the KPI. The framework specifies that the final report will be made available within 90 days of the target observation date. Additionally, the issuer commits to disclosing an illustration of the positive sustainability impacts of the performance improvement, which we view as a strength of the framework.

Post-issuance review

Alignment  Baltic Horizon Fund’s Sustainability-Linked Bond Framework is aligned with this component of the SLBP.

BHF commits to annual external verification of its performance against the KPI, and to publishing the certificate annually on its website.

Framework Assessment

Selection of key performance indicators (KPIs)

The Principles make optional recommendations for stronger structuring practices, which inform our relevancy opinion as aligned, strong, or advanced. For each KPI, we consider how relevant the KPI is for sustainability by exploring the clarity and characteristics of the defined KPI; its significance for the issuer’s sustainability disclosures; and how material it is to the issuer’s industry and strategy.

 Baltic Horizon Fund’s Sustainability-Linked Bond Framework is aligned with this component of the SLBP.

KPI	Renewable electricity consumption in the portfolio (kWh by percentage of gross area)	Not aligned	Aligned	Strong	Advanced
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We consider the KPI selected by the issuer to be aligned with the Principles because the scope, objective, and calculation methodology are articulated in the framework. The KPI addresses a topic material to the real estate sector that is linked to the funds' sustainability strategy.

The KPI's scope and objective are clearly stated in the framework, that is, its aim is to increase the use of renewable electricity within BHF's entire portfolio to reduce its carbon footprint, thus helping the group reach its net zero objective by 2030. The KPI is calculated as a percentage of the gross area of the total portfolio, and measures the area that is subject to a supply agreement for renewable electricity on the measurement date. Renewable sources listed in the framework include wind power, solar photovoltaic (SPV) technology, concentrated solar power (CSP) technology, or hydropower. Although the methodology is clear, in our view, it does not follow widely recognized international standards, which would allow for better external benchmarking.

We believe the KPI addresses a topic that is material for the real estate sector, that is, greenhouse gas emissions and energy use during the life of the assets (see "Key Sustainability Factors: Real Estate," published July 20, 2021, on RatingsDirect). The KPI tackles climate change mitigation although, in our view, the link is somewhat indirect--it measures floor area covered by a contract to supply renewable electricity for consumption. We consider that measuring scope 2 emissions would be a more direct link. In addition, this KPI is not widely used or reported in the market. Scope 2 emissions contribute the largest portion of the funds' total footprint at 65%, with the largest share coming from electricity use, followed by heating in premises managed by tenants. We acknowledge that BHF can only influence electricity sources because the heating is supplied by a district heating provider. In this regard, the KPI tackles one of the most relevant elements of the fund's sustainability strategy; specifically, its intention to switch to renewable energy sources to help reduce its most material source of emissions.

Calibration of sustainability performance targets (SPTs)

The Principles make optional recommendations for stronger structuring practices, which inform our opinion of the issuer's ambition as aligned, strong, or advanced. We consider the level of ambition for each target by assessing its clarity and characteristics, how the issuer defines the target with reference either to its past performance, or to external or competitor benchmarks, and how it explains what factors could influence future performance.

 Baltic Horizon Fund’s Sustainability-Linked Bond Framework is aligned with this component of the SLBP.

SPT	By May 30, 2025, at least 80% of the portfolio by gross area shall use renewable electricity	Not aligned	Aligned	Strong	Advanced
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We consider that the ambition, clarity, and characteristics of the SPT meet the requirements set out by the Principles. BHF's goal is to ensure at least 80% of the total gross area of its portfolio will be covered by renewable electricity in 2025. The framework outlines BHF's historical performance, demonstrating that its strategy to increase renewable electricity consumption is nascent. In 2018, 16% of electricity consumption in its portfolio was from renewable sources, but this fell to zero in 2019 and 2020, before increasing to 42% in 2021. Metrics have been inconsistent because BHF first introduced its goal of intentionally procuring renewable electricity

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contracts in 2021. Its historical performance data has not been externally verified; market participants typically perform this step, which we consider a more advanced practice. That said, the fund has reported total electrical energy usage for its portfolio within its sustainability report since 2018; this provides some level of confidence regarding the historical data, even if the breakdown of renewable and nonrenewable electricity is not publicly available. To achieve the 80% target, the fund needs to switch a further 38% of its contractual electricity consumption to renewables by 2025. This is a smaller increase than it has previously achieved. However, as energy supply contracts are short term in nature, we understand that all contracts will have to be renewed at some point, and before the observation date, to meet its target. In other words, the fund must sign contracts to provide renewable electricity to 80% of its gross portfolio area, which is more than it has previously achieved.

The issuer has provided some information on its strategy for reaching the target by May 30, 2025 (the observation date). It plans to sign short-term, mainly virtual, power purchase agreements (PPAs) with energy suppliers. Wherever possible, BHF will use on-site generation, but in the past it has ruled out installing solar PV panels on some properties because of their age or because restrictions prevent the installation of solar panels on the roof. We consider that focusing on short-term mechanisms to achieve the target is a limitation. It makes it possible for the issuer to achieve the target by the observation date, but not sustain that level of provision over time. Nevertheless, we acknowledge the group's net zero target for 2030, and BHF's role in achieving this objective in the long term.

Going forward, the fund intends to sign physical PPAs and so secure a supply of green electricity from local producers for part of its portfolio, which we view as positive. Physical PPAs can drive the expansion of renewable energy generation (additionality), which mechanisms like the purchase of unbundled certificates to offset scope 2 emissions cannot. Although the fund does not follow an internal hierarchy for scope 2 emission reduction (that is, it does not focus first on mechanisms with more additionality, such as on-site generation and physical PPAs), it does intend to reduce emissions as much as possible, rather than offsetting them, which we view favorably.

Standard market practice is to benchmark targets against peers or against a sector standard; the issuer has not done this and, in our view, this limits our ability to opine on how ambitious the target is. Therefore, our score is capped at aligned. However, the framework states that if the SPT is achieved, scope 2 emissions would be reduced by 12%, which we view as a material improvement for the company.

Baseline	By May 30, 2025, at least 80% of the portfolio by gross area shall use renewable electricity
2021	2025
42%	≥80%

Instrument characteristics

The Principles require disclosure of the type of financial and/or structural impact involving trigger event(s), as well as the potential variation of the instrument's financial and/or structural characteristics.

 Baltic Horizon Fund's Sustainability-Linked Bond Framework is aligned with this component of the SLBP.

BHF discloses under its sustainability-linked bond framework that instruments under the framework will be subject to increased interest rates, triggered by observed performance against the stated SPTs, and specifically discloses the applicable adjustment, which we view as a strength.

The framework specifies that if the SPT is not met by the target observation date, the interest rate will be adjusted upward by 50 bps a year, from the applicable interest period, until the bond matures, and that this will be stipulated in the specific bond documentation.

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It also includes a fallback mechanism by which if the issuer fails to calculate the SPT for the final sustainability report, or fails to publish the final sustainability report, the interest rate will be adjusted upward by 50 bps a year. The increase will be applied from the interest period that includes the interest rate step-up date, until the date when the final Sustainability Performance Report is published or the final redemption date, whichever is sooner.

The 50 bps step-up if the target is not met by the observation date exceeds the step up typically applied in sustainability-linked transactions (25 bps). In our view, the inclusion of a 50-bps fallback mechanism is an advanced practice. We consider that it demonstrates BHF's commitment to sustainability and constitutes a best practice in the market.

Although this framework covers potential issuances at the fund level, there is also bank financing in place, at the assets level. We understand that asset-level debt is unlabeled, which mitigates the risk of double-counting, that is, the possibility that the same underlying assets might be used twice in two labelled instruments.

Reporting

The Principles make optional recommendations for stronger disclosure practices, which inform our disclosure opinion as aligned, strong, or advanced. We consider plans for updates on the sustainability performance of the issuer for general-purpose funding, or the sustainability performance of the financed projects over the lifetime of any dedicated funding, including any commitments to post-issuance reporting.

 Baltic Horizon Fund's Sustainability-Linked Bond Framework is aligned with this component of the SLBP.

Disclosure score

Not aligned

Aligned

Strong

Advanced

We consider BHF's overall reporting practices to be strong.

The issuer commits to publish an annual sustainability performance report on its website. The report will be published within 90 days of the end of the financial year and will include any updates relevant to the analysis of the target, to enable investors to monitor the performance against the KPI. The framework specifies that the final report will be made available within 90 days of the target observation date.

Additionally, the issuer commits to disclose an illustration of the positive sustainability impacts of the performance improvement, that is, quantitative or qualitative data explaining greenhouse gas emission reductions in relation to the performance against the KPI for the SPT. We view this as a strength of the framework and its transparency commitments.

Post-issuance review

The Principles require post-issuance review commitments, and specify the type of post-issuance third-party verification, its periodicity, and how this will be made available to key stakeholders. Our opinion describes whether the documentation is aligned or not aligned with these requirements. Please note, our second party opinion is not itself a post-issuance review.

 Baltic Horizon Fund's Sustainability-Linked Bond Framework is aligned with this component of the SLBP.

BHF commits to an annual verification of its performance against the SPT, with a limited level of assurance, by its external auditor. The limited assurance report confirming annual performance of the KPI relative to the SPT will be made publicly available on the fund's website.

Mapping To The U.N.'s Sustainable Development Goals

The Sustainable Development Goals (SDGs), which the United Nations (U.N.) set up in 2015, form an agenda for achieving sustainable development by 2030.

Baltic Horizon Fund's Sustainability-Linked Bond Framework intends to contribute to the following SDG:

KPI

Renewable electricity consumption in the portfolio (kWh by percentage of gross area)



13. Climate action

*The KPI is likely to contribute to the SDGs.

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