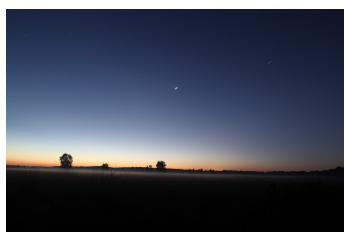


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Article | 5 February 2021

Covid-19 and the eurozone economies in 2021: Darkest before dawn?

The eurozone economy will continue to be dominated by the coronavirus, much as in 2020. Optimism prevails for the latter part of the year though as vaccinations are expected to boost economic recovery. Don't expect the ECB to remove support quickly though



Source: Shutterstock

With lockdowns extended into the new year, it really feels like it is darkest before dawn in the eurozone. In the first quarter, GDP is all but certain to contract again and the question is now by how much. Vaccination programmes have started off slowly, but are expected to pick up speed once teething troubles are smoothed out. We expect the combination of lockdowns and vaccinations will allow for more substantial reopening of economies over the course of the second quarter. This will then also mark the start of the recovery of the eurozone economy.

The recovery will pick up steam once vaccinations are more widespread and the virus retreats more permanently. For the second half of the year, that will likely result in a strong growth recovery, further boosted by the Recovery and Resilience Fund that will start to disburse grants to EU countries. This will coincide with a period of stronger inflation, which is partly mechanical. Energy inflation will be higher on the back of a reversal of the oil price decline seen in March last year and the German VAT decrease of last year is not renewed. Social distancing price categories are also likely to make up for discounts given during coronavirus times, which makes a temporary

surge to around 2% a possible scenario.

Fig 1 Large uncertainty surrounds the 2021 outlook for eurozone economies

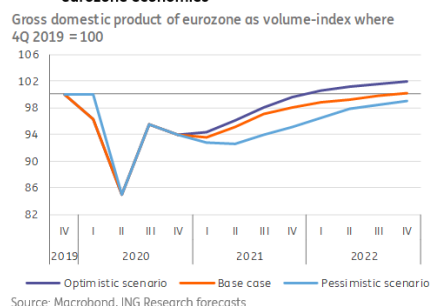
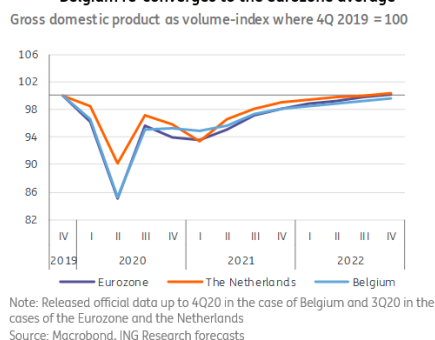


Fig 2 While Dutch GDP performs above the eurozone, Belgium re-converges to the eurozone average



The ECB is not expected to reduce support quickly as the economy recovers. While inflation could temporarily tick higher, the ECB is focused on the medium-term inflation outlook for its policy making and the medium-term outlook is not improving much. In fact, with unemployment trending somewhat higher and output gaps very negative, it is likely that it will take longer than expected pre-crisis before inflation is sustainably returning to just below 2%. The pandemic emergency purchase programme (PEPP) has already been announced to run until spring 2022 and early tapering is unlikely to become a theme for this year. There is huge uncertainty surrounding this base case though, which makes it worth looking at other possible scenarios as well. Given the importance of vaccine rollouts and lockdowns for the economy, those are the drivers of the various scenarios we look at.

- A more optimistic take would be one in which lockdowns succeed in bringing down new cases very substantially and improved testing capability compared to the first wave allows new cases to be kept at a very low level. This, together with a speeding up of vaccination efforts that inoculates the vulnerable population within a matter of weeks, would lead to an aggressive reopening of the economy and could lead to 4.1% GDP growth for the year.
- A downside scenario that we look at is one in which mutations of the virus require longer and stricter lockdowns that last well into the first half of the year and still impact summer holidays substantially. Thanks to mutations, roll-out of vaccines takes longer due to required adjustments and this delays herd immunity until 2022 or later. In this scenario, GDP growth would drop to just 0.9% for the year.

☑ The Netherlands: higher volatility, but more resilience

Like other eurozone economies, the Dutch economy took a big blow from the Covid-19 crisis, leading to a GDP decline of roughly 4% for 2020. However, with a below-eurozone-average contraction in the first half of the year (-9.9%) and an unexpectedly strong rebound in the third quarter to 97% of the pre-crisis peak of the fourth quarter of 2019, the Dutch economy had a relatively favourable GDP performance during the bulk of last year. This was probably related to a combination of the comparatively looser “intelligent lockdown”, the effectiveness of discretionary fiscal support policies and size of automatic stabilisers, a favourable sector composition (tourism is relatively small), an above-average digital infrastructure together with a large share of the economy that does work that can be done from home (such as business services).

We project negative growth for the Dutch economy, while the Eurozone GDP stays flat and the Belgian economy already starts to rebound compared to the fourth quarter

As in Belgium, the number of Dutch Covid-19 cases started to rise again in the autumn, earlier than in the rest of Europe. While this resulted in a significant peak of cases in October in Belgium, the Netherlands kept the curve flatter but for much longer. The high level of novel cases around Christmas, which has been coming down gradually since, and the return to lockdown mid-December translates into a negative GDP growth for the fourth quarter in 2020 and a below-average first quarter of 2021. In fact, we project negative growth for the Dutch economy, while the Eurozone GDP stays flat and the Belgian economy already starts to rebound compared to the fourth quarter. We assume that the strict lockdown will end in the first quarter in the Netherlands, with only a gradual unwinding of social distancing measures. Even though the Netherlands will be a long way off herd immunity by then, the second quarter of 2021 should see increased levels of mobility and a GDP rebound to a level close to but still below that of the third quarter of 2020.

Even though the current Dutch second lockdown is stricter than the first that started in March 2020, GDP seems to be holding up somewhat better now, for a number of reasons:

- Businesses are better prepared with new business models (such as restaurants switching to home deliveries) and are dealing with less uncertainty, given that many fiscal support instruments were already in place and automatically fluctuate with a firm's turnover.
- Consumers are more used to online shopping and businesses have their distribution channels more in order.
- Manufacturing is holding up better, facing fewer input supply restrictions from, for example, China.
- As a trading nation, the Netherlands is benefiting from the recovery of world trade. While service exports are still weak, goods exports are higher than before the crisis hit.

Given the resilience shown after the opening of the first lockdown, we assume a strong rebound mid-2021 as well, which might be facilitated by the substantial presence of flexible relations in the Dutch labour market. In our pessimistic scenario, in which the virus calls for more caution and the vaccination process remains slow, economic activity might be more suppressed in the first half of the year, only to start a slow gradual recovery in the second half of the year.

Dutch public finances were in good shape going into the crisis, with debt levels much lower than the eurozone average and Belgium. Only after the January 2021 announcement of additional support for the first two quarters of 2021 is Dutch debt expected to go above the European norm of 60% of GDP. In light of new elections, the reforms that would be required and the ease of financing its own debt, the current government decided not to apply for support from the European Recovery Fund yet. Elections for the Dutch House of Representatives are to be held on 17 March, which might bring about some uncertainties. Current polls suggest that the majority of the electorate supports the parties making up the current coalition government, even though it stepped down prematurely because of the so called "childcare allowance" affair. Given the likelihood of a high number of parties, probably four at least, involved in the process of forming a

new government, we expect it to take longer than the historical average of 94 days to install the new government.

We expect it to take longer than the historical average of 94 days to install the new government

Positive for the economy is the fact that opposition parties have given the caretaker government ample room to handle the Covid-19 crisis, even though on other controversial topics the government will refrain from taking new initiatives. This also means there is room for more fiscal stimulus, if deemed necessary.

All in all, we project the Dutch economy to rebound somewhat stronger than the eurozone and Belgium, possibly with a bit more volatility at the start of the year.

Belgium: in the middle of the pack

Although Belgium was very hard hit by the pandemic in 2020 (it still has one of the highest mortality rates in the world due to the pandemic), the economic impact was within the European average. With a GDP contraction of around -6.2%, the situation in 2020 is worse than in Germany (-5%), but better than in France (probably -8.3%). In particular, it should be pointed out that the rebound in the economy in the third quarter, when the restrictive measures were eased, was surprisingly strong. The fact that German industry performed well in the second half of the year probably played in favour of Belgian exporters during that period.

This being said, Belgium also stands out for its very large second wave of the pandemic (larger than the first) which hit the country early (as early as October). As a result, the authorities had to take drastic measures to curb the pandemic, and to do so more forcefully than most other European governments. Most of these measures are still in force today and will probably be in force until March. In the face of the upsurge of cases in many countries, it can be seen that many have more recently taken the same type of measures. For the first quarter of this year, as in the Eurozone, we do not anticipate a recovery.

As in most eurozone countries, assuming that there are no nasty surprises in the vaccination process, we expect the recovery to gain traction over the course of the second quarter. The second half of the year should also be marked by an acceleration in activity.

Compared to the scenario for the eurozone as a whole, we will nevertheless pay attention to three elements:

- The situation of Belgian public finances was among the worst at the start of the crisis. Since the situation has deteriorated sharply, the room for manoeuvre for financing a recovery plan will be narrower than in most other euro area countries. This could weaken the recovery path in the coming years. Admittedly, the European Recovery Fund should grant some €6billion to Belgium. But more will be needed to get the economy back on track.
- Moreover, we know that once the urgency of the pandemic has passed, political tensions

may take over. It should be remembered that it took 17 months to form a federal government. It now brings together no fewer than 4 political families, sometimes with diametrically opposed ideas. Questions about economic recovery and its financing in a difficult fiscal framework risk exacerbating the tensions already present.

- Lastly, given the very high degree of openness of the economy, the recovery path will also depend on the global economic context and the economic health of Belgium's main trading partners. This may have a positive effect on growth, for example if Germany succeeds in strongly reviving its activity. But it can also have a negative effect, for example if protectionism continues to rise. The presence of many multinationals will also have to be monitored; major restructurings impacting the Belgian sites of multinationals have already been announced, which could make the labour market deteriorate more than in other countries.

In conclusion, we believe that Belgium will not be far from the trajectory of the eurozone. But it will not be at the head of the pack.

Author

Marcel Klok

Senior Economist, Netherlands

marcel.klok@ing.com

Philippe Ledent

Senior Economist, Belgium, Luxembourg

philippe.ledent@ing.com

Bert Colijn

Chief Economist, Netherlands

bert.colijn@ing.com

2021 Outlook for Belgian and Dutch housing markets

Given the pandemic, the steep house price increases seen in both Belgium and the Netherlands last year were a surprise. However, three factors helped to drive confidence and demand in the housing market. Firstly government support, secondly, increased investor activity and finally a further decrease in interest rates improved affordability of homes



Belgium

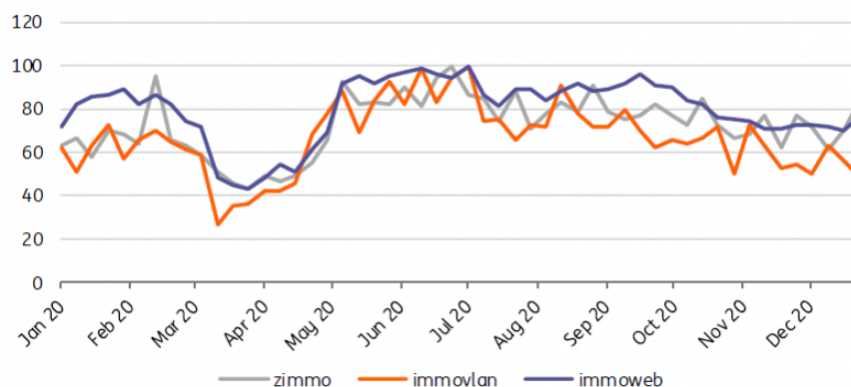
House price growth was unexpectedly strong in 2020 in Belgium. Income support provided by the government, increased activity by investors and low interest rates can explain the strong growth. Looking at 2021, we expect the upward pressure from these factors to fade, leading to more modest growth figures for the year.

Interest in residential real estate in Belgium recovered rapidly after the first lockdown in March 2020. The number of Google searches made to well known Belgian real estate websites even rose to a level that was higher than before the lockdown and a recovery in the number of transactions followed.

Interest in real estate recovered rapidly after the first lockdown in Belgium

There is evidence that housing preferences shifted during the crisis with more interest than usual in houses and apartments that were larger and had a garden or terrace.

Fig 3 Belgium: Evolution of Google searches to well known real estate websites



Source: google trends

Despite the rapid recovery in activity, the number of transactions for 2020 as a whole is expected to be much lower compared to 2019 (official figures will only be published in April). This is obviously due to the disruption from Covid-19 lockdowns, but also to do with the abolition of the 'woonbonus' in Flanders, a system of tax deduction for households with a mortgage. The announcement of the abolition led to a rush on real estate at the end of 2019.

House price evolution is expected to be remarkably positive when official figures for 2020 as a whole become available in April. Unofficial sources point to house price increases of close to 6%. Part of this sharp growth could be explained by the shift in preferences by house buyers towards more expensive houses. If a greater number of expensive houses was sold during 2020 compared to 2019, then the median price will increase. So part of the price increase might be explained by a composition effect.

But there are also several macroeconomic factors that explain the vibrant price evolution. A first crucial factor is the interest rate. The European Central Bank did everything it could to keep the market rate down and we see that this translated into a decline in the average mortgage rate in Belgium in 2020. Low mortgage rates are a fundamental aspect of the purchasing power of households as a small change in the mortgage rate has a large impact on the loan capacity. If the mortgage rate drops from 1.7% to 1.4%, as it did over the course of 2020, then the loan capacity increases by 3% for a mortgage with a maturity of 20 years.

Several macroeconomic factors explain the vibrant price evolution

The fall in the average mortgage interest rate, however, is also related to the macroprudential policy pursued by the National Bank of Belgium. Under new rules in force since January 2020, there are restrictions on the loan amount in relation to the value of the home (loan-to-value ratio). This ensures that banks grant fewer loans with very high loan-to-value ratios. As these new loans are

less risky, they have a lower mortgage interest rate, and so the average mortgage interest rate falls.

A second factor contributing to the strong price growth has been the income supporting measures from the government. Income loss for households on a macroeconomic level was moderate due to these policies. The moratorium on mortgage payments also supported prices in ensuring fewer forced sales, which are generally a cause of downward price pressure.

Furthermore, those households that suffered loss of income as a result of the pandemic are generally not the households that are looking to buy a house. Home ownership is lower among lower income households, and the Covid-19 crisis has had a greater negative impact on sectors in which average wages are lower.

Lastly, we note that the low yield on bonds and high volatility of the stock market over 2020 made an investment in physical real estate more attractive for many Belgians. Hence, real estate investors also supported house prices.

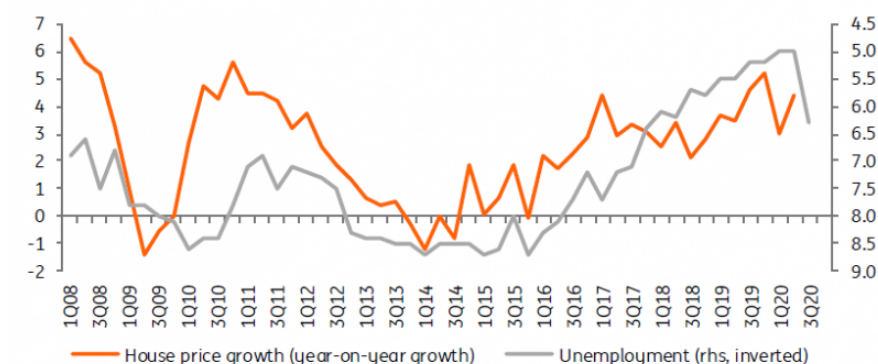
Can this high house price growth continue?

The factors that influenced the high house price growth in Belgium in 2020 will fade over the coming months, we believe. The second wave of the pandemic and the negative effects of the first wave will cause unemployment to rise, even in sectors not directly affected by the pandemic, putting downward pressure on house prices.

Factors influencing high house price growth in 2020 expected to fade

The Belgian government's income support measures are expected to become more targeted during the second wave and will inevitably result in a loss of income for a larger number of families. And the moratorium on mortgage interest payments will eventually expire. In addition, the strong house price increases will dampen the attractiveness of real estate for investors.

Fig 4 Belgium: Clear link between unemployment rate and house price growth (%)



Source: Refinitiv

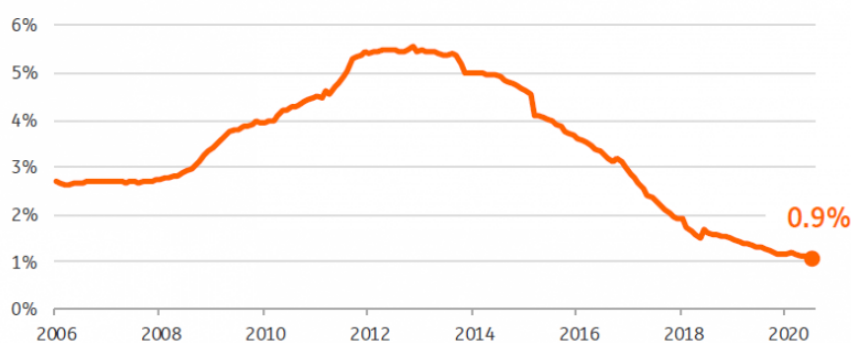
In 2021, we expect the real estate market to cool, with lower quarter-on-quarter growth figures.

However, due to base effects, the expected growth for the full year is still high, at 3%.

The Netherlands

The Dutch housing market is still showing strength despite the Covid-19 crisis. Stable affordability, increased activity by investors and further tightening of the housing market explain why prices have on average increased by 7.8% on an annual basis (+6.9% in 2019). For 2021, we assume a cooling of the housing market, but the surrounding uncertainties are higher than normal. The pace of economic recovery and developments in confidence in the housing market and interest rates will largely determine the impact of the crisis on the housing market in 2021.

Fig 5 Netherlands: Share of homes for sale historically low



Source: CBS, huizenzoeker.nl, modified by ING Economisch Bureau

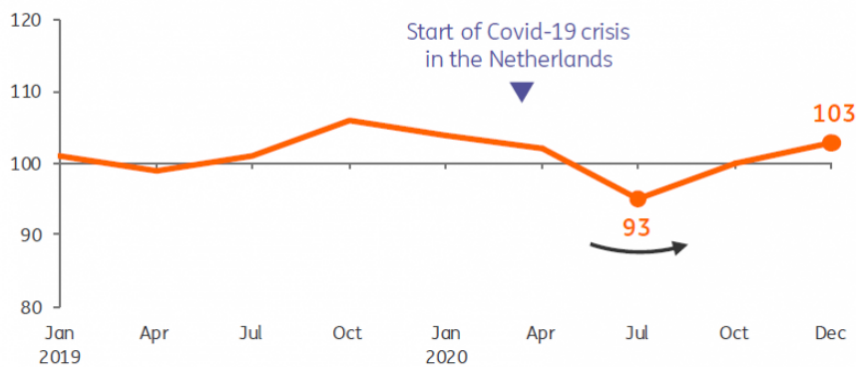
1) Affordability maintained in 2020

Two factors positively affected the affordability of homes in 2020: disposable income increased on average, while unemployment among potential home buyers remained low. It was mainly young people with flexible employment contracts that faced unemployment due to the Covid-19 pandemic in 2020. In combination with a further fall in mortgage interest rates of around 0.3ppt on average, this has sustained the affordability and demand for homes.

2) Increased activity by investors in 2020

Investor interest in the housing market has increased further. In the first half of 2020, private landlords accounted for about 20% of all home purchases, a higher rate compared to the same period in 2019. This has put extra upward pressure on house prices. An increase in transfer tax from 2% to 8% for buy-to-let houses as of January 2021 has led to a year-end rush by investors, providing further upside pressure to the market in 2020.

Fig 6 Netherlands: Quick recovery of confidence in housing market, after small dip (100=neutral)

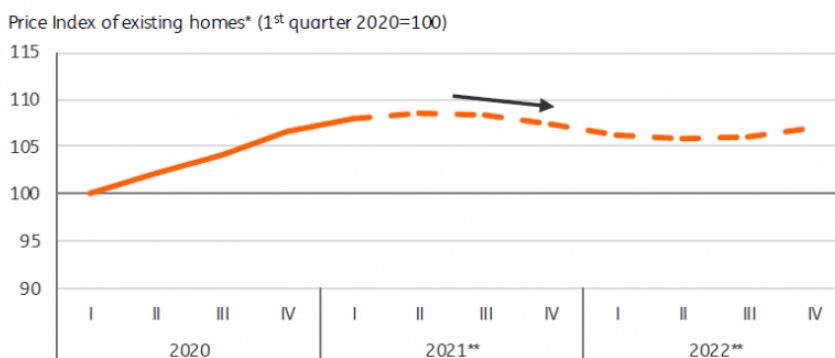


Source: Vereniging Eigen Huis

3) Confidence bounces back to normal and further tightening of housing market

Unlike in previous economic crises, Dutch consumers have remained confident in the housing market. This partly explains the 7.7% increase in the number of home sales in 2020 compared to 2019. A further tightening of the housing market has been the result, as becomes clear from the share of owner-occupied homes that are for sale. This share fell from 1.2% to 0.9% during 2020, the lowest level ever reported. The rapid recovery of confidence in the housing market can be explained by two factors. First, as already mentioned, income losses of potential home buyers have so far been limited. This is due to the government’s stimulus policy in response to the crisis. Second, the Covid-19 crisis is not caused by vulnerabilities in the economy, but has an epidemiological cause and rapid economic recovery seems possible once the virus is under control. Both factors contributed to the quick recovery of confidence in the housing market in the second half of the year, after a small decline from April to July. The quick recovery of confidence has prevented a drop in home sales and resulted in a further tightening of the housing market in 2020. This helps to explain last year’s strong activity in the Dutch housing market.

Fig 7 Netherlands: Mild decrease in house prices over second half of 2021



*corrected for seasonal effects, **forecast ING
Source: Statistics Netherlands

Base case for 2021: cooling down of the housing market

ING takes a cooling down of the Dutch housing market as base case for 2021. The economic impact of the Covid-19 crisis and phasing out of government support will lower confidence levels in 2021. And unlike in 2020, the crisis will increasingly affect people with fixed employment contracts in 2021. As a result, potential home buyers will more often postpone their purchasing plans. A

gradual increase in interest rates with a more moderate wage increase than in 2020 will, on average, mean affordability declines. First time buyers – about 30% of the market - will experience a windfall, as for them the transfer tax of 2% no longer applies. Higher interest rates, higher transfer taxes for buy-to-let and lower rents will, on the other hand, discourage investors. Hence, in our base case scenario we assume a flattening of price increases in the first half of 2021, followed by a mild decline in house prices continuing until the beginning of 2022. At the lowest point, we see house prices about 2.5% lower on average than the price peak in 2021. On an annual basis, house prices in our base scenario are still 5.0% higher compared to the 2020 average². Home sales are expected to fall by 10% in 2021 compared to last year, due to lower confidence levels and the limited supply of homes.

...but uncertainties for second half of the year are greater than ever

Our base case, however, could easily become outdated. Uncertainties on the housing market are greater than ever. First, there is uncertainty about the economic impact of the Covid-19 crisis. Second, the role of psychological factors on the housing market increase uncertainty levels around short-term house price developments. Future confidence in the housing market will be a result of a mixed bag of influences, such as unemployment development, economic performance and interest rate developments. A turn in confidence could happen rapidly. Together with the high cyclicity of the housing market and many self-enforcing mechanisms, this amplifies the possible impact of the crisis on the housing market. The most positive scenario is a situation in which the economy recovers fast, the Covid-19 virus is successfully controlled and interest rates remain low. This will support consumer confidence and limit income losses of households, thereby preventing a significant drop in housing demand. In this scenario, wealth effects of second-time buyers could lead to even further prices increases. If, however, economic recovery takes longer, uncertainties related to the pandemic remain high and push risk premiums in mortgage rates up, and this could result in plunging housing demand and lower house prices.

Author

Mirjam Bani

Sector Economist, Commercial Real Estate & Public Sector (Netherlands)

mirjam.bani@ing.com

Sustainable markets

The European Commission's technical screening criteria for green buildings may not be a major game-changer for the issuance of green bonds, as long as issuers offer proper transparency regarding the extent their green bonds are taxonomy aligned with EU regulation. That said, the criteria could become an increasingly important differentiating factor



Source: Shutterstock

In November last year, sustainable markets experienced some turmoil following publication of the European Commission's draft delegated act establishing the technical screening criteria for climate change mitigation and climate change adaptation³. Climate change mitigation and climate change adaptation are the first two of the six environmental objectives set by the EU taxonomy regulation that came into force in July 2020.

The EU taxonomy regulation classifies economic activities as environmentally sustainable only if they meet one of the six sustainability objectives, do no significant harm (DNSH) to any of the other environmental objectives, are compliant with the defined minimum social safeguards, and comply with the technical screening criteria.

The EU taxonomy identifies the following six sustainability objectives

- 1) Climate change mitigation
- 2) Climate change adaptation
- 3) Sustainable use and protection of water and marine resources
- 4) Transition to a circular economy, waste prevention and recycling
- 5) Pollution prevention and control
- 6) Protection and restoration of biodiversity and ecosystems

The technical screening criteria will be set by separate delegated regulations. The criteria for climate change mitigation and climate change adaptation should become applicable per 1 January 2022, while the technical screening standards for the other objectives will be established at a later stage and should apply from 1 January 2023.

The technical screening criteria are an important input variable to financial markets participants in light of their sustainable disclosure obligations

The finalisation of the technical screening criteria is, for many financial market participants and financial advisers, the anxiously awaited missing piece of the taxonomy puzzle. After all, as of 10 March 2021 they have to disclose to what extent their financial products or investments qualify as environmentally sustainable under the sustainable finance disclosure regulation (SFDR). Knowing whether their products or investments meet the technical screening criteria is therefore key.

However, finalising the technical screening criteria is proving to be a longer process for the European Commission than initially anticipated. The main reason is the flood of questions raised during end of last year's consultation period regarding the November draft proposals. In particular, the technical screening criteria proposals for buildings received substantial pushback from sustainable market participants.

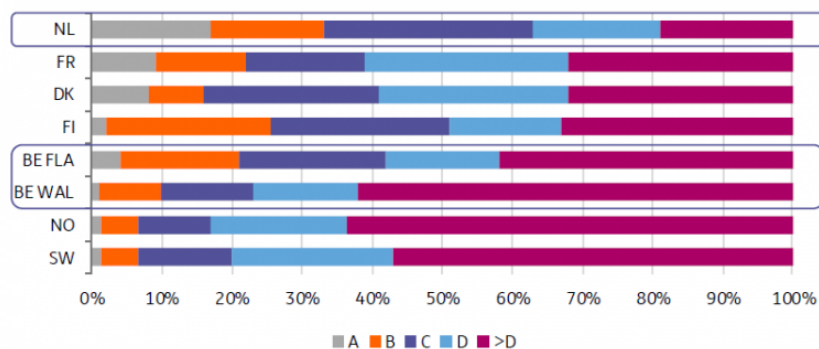
The green buildings criteria issue: the shift from best-in-class to EPC

Within the draft delegated act, the European Commission proposed to subject buildings built before 31 December 2020 to a class A energy performance certificate (EPC) requirement. For some countries, this would leave a negligible part of their building loans as eligible, as:

- Parts of the building stock would not have EPC labels to begin with, while
- Only a small part of the labelled buildings have an A class EPC certificate.

The Benelux makes a good example of the regional differences. The Belgian market is impacted far harder by this criterion (1-4% of the buildings are EPC class A) than the Netherlands where 17% of the labelled properties have an A certificate (Figure 29).

Fig 29 EPC labels pose a tougher restriction on Belgian than on Dutch building assets



This chart only gives an EPC label distribution for buildings that have EPC labels and therefore does not represent the shares of each label within the total building stock. For Sweden an average of different building types is taken. Source: X-TENDO (March 2020) and SBAB green bond impact report, ING

This should get better over time on the back of all the national incentives to improve the energy efficiency of existing buildings through renovation. Think, for example, of the EPC label premium introduced in Flanders, which offers a lump sum contribution of as much as €5,000 for renovations to label A. However, these renovation processes will take time. Meanwhile banks and asset managers seeking to contribute to the financing of the energy transition in buildings may be hindered in doing so by the tight EPC straitjacket.

Understanding national EPC label differences is a hard nut to crack

That many were caught off guard by the European Commission's proposals for green buildings can be explained by the shift that was made versus the technical screening criteria recommendations of the Technical Expert Group (TEG) in March last year⁴. In line with market practice, the TEG proposed the use of a best in class approach, where green buildings should belong to the top 15% low-carbon buildings. Certification schemes such as EPCs could be used as evidence of meeting the top 15% requirement. However, the TEG explicitly refrained from mentioning a minimum EPC reference level, recognising that more work needed to be done in order to define the absolute thresholds corresponding to the top 15% of the building stock.

Indeed, it is commonly known that EPC labels differ widely from country to country and often lack comparability. Some countries use primary energy demand as a reference, while others refer to final energy use. Some jurisdictions have set their EPC label requirements on a country level, whereas elsewhere EPC definitions are set on a regional level and may vary from region to region. In some regions, the EPC criteria may differ per property type (for instance, houses versus apartments or residential versus commercial buildings). While most label definitions are ultimately based on a measure of the energy used in kWh/m²/y, there are also countries that express their labels in terms of a building's energy performance in comparison to a reference building. For those

that do, even the simple definition of a reference building is far from uniform. Figure 30 highlights some of these applicable differences for the Netherlands and Belgium. The result is that countries that have set the strictest A label definitions, may be harmed the most by technical screening criteria that use EPC labels as a reference for green buildings.

Fig 30 EPC label criteria in Belgium and the Netherlands for residential buildings

	Brussels Primary energy demand kWh/m ² per year	Flanders Primary energy demand kWh/m ² per year	Wallonia Primary energy demand kWh/m ² per year	Netherlands Primary energy performance kWh/m ² vs model residence	(per 1 January 2021) Primary fossil energy use kWh/m ²
A++++				≤ 0.2	≤ 0
A+++				≤ 0.4	≤ 50
A++			≤ 0	≤ 0.6	≤ 75
A+		≤ 0	≤ 45	≤ 0.8	≤ 105
A	≤ 45	≤ 100	≤ 85	≤ 1.2	≤ 160
B	≤ 95	≤ 200	≤ 170	≤ 1.4	≤ 190
C	≤ 150	≤ 300	≤ 255	≤ 1.8	≤ 250
D	≤ 210	≤ 400	≤ 340	≤ 2.1	≤ 290
E	≤ 275	≤ 500	≤ 425	≤ 2.4	≤ 335
F	≤ 345	≤ 600	≤ 510	≤ 2.7	≤ 380
G	> 345	> 600	> 510	≥ 2.7	≥ 380

Source: Various national and international sources, ING

So what now?

Given the amount of push back received by the European Commission regarding the draft technical screening criteria for buildings, it is by no means certain that the EPC label of A will remain the key reference for buildings built before 31 December 2020. It may very well be that the European Commission will re-introduce the 15% best in class approach in line with the TEG proposals, and/or loosen the EPC label criteria to include an EPC label of B. The latter would align the EPC label reference for buildings with the European Commission's 'do no significant harm' to climate change mitigation proposals under the climate change adaptation objective. An EPC label B reference would also be in line with the TEG's first technical screening criteria recommendations. Both would allow banks to identify a significantly larger portfolio of taxonomy aligned assets for green bond issuance purposes than under the current EPC label A recommendations.

However, the latter option (broaden the EPC label criterion to include class B buildings) would still not solve the fact that differences in national EPC label methodologies may result in buildings being labelled A or B in one country, while for a country with a similar type of building stock but stricter EPC criteria, a comparable building could be labelled C. Another complicating factor is that, for banks issuing green bonds, it is often not as straightforward as it may seem to know, or otherwise obtain, the required EPC label information for their mortgage lending books. This is why issuers often rely on year of construction information to be able to identify the 15% most energy efficient buildings.

Even in the event of an A EPC label outcome green bond issuers can opt to disclose the share of taxonomy aligned green assets

That said, even in the worst-case scenario where the EPC label of A is maintained as a technical screening criterion for existing buildings, banks may still continue to apply a 15% best in class approach. This would give them ample opportunity to issue green bonds while, for investors, transparency on the percentage of the green asset portfolio that is taxonomy aligned may withstand. After all, for SFDR disclosure purposes it should be sufficient for investors to know which share of their bond investments can be considered environmentally sustainable under the

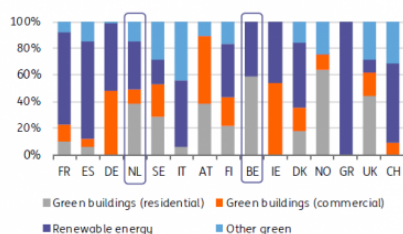
taxonomy's definition.

However, while an A label outcome does not necessarily have to hinder the primary market activity in green bonds, it could become a differentiating factor to the performance of green bonds. After all, financial market participants are likely to search for those bonds in particular that provide them with a high taxonomy alignment, or otherwise request more compensation from bonds that are less taxonomy aligned.

The impact on Benelux green bonds

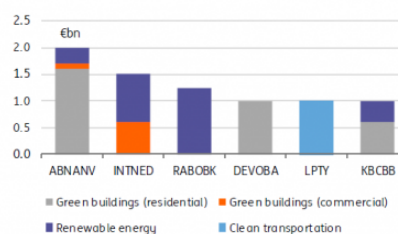
The Netherlands and Belgium are among the markets for which the technical screening criteria for green buildings is of high relevance for the green bond issuance by banks. After all, 49% and 59%, respectively, of the (non-covered) green bond proceeds in these markets has been allocated to green building assets. In other markets, such as France and Spain, almost 70% of the green bond proceeds is allocated to renewable energy loans.

Fig 31 Benelux banks allocate quite a bit to green buildings



Source: Issuer allocation reports, ING

Fig 32 Use of proceeds by Benelux green EUR bond issuers



Source: Issuer allocation reports, ING

Nonetheless, even in the Benelux market the use of proceed differences are substantial. Some allocate 100% of their green bond proceeds to residential buildings, while others allocate 100% of their proceeds renewable energy loans, or to clean transportation.

Banks that are not impacted by the strict building criteria because they allocate their proceeds to other assets, such as renewable energy loans, may face less difficulty meeting the technical screening criteria and may see this being rewarded with a better taxonomy alignment and consequently tighter pricing levels for their green bonds.

Dutch banks already refer to an EPC label of A in their green bond frameworks

However, as discussed above, the Netherlands is one of the few countries in which the portion of building assets in the EPC label category of A is quite high. For that reason, Dutch banks already apply a minimum EPC label of A as one of the asset eligibility criteria for green buildings in their green bond frameworks.

KBC remains the only Belgian issuer of green bonds to date. The issuer's current green bond framework does not use EPC labels as its selection criterion. Instead, for residential real estate assets the requirements of the Flemish Region building code as of 2014 or later (E-level ≤ 60) are

used as a reference, under the condition that the first drawdown has occurred after 1 January 2016.

Figures 33 to 36 give an overview of the current trading levels of Belgian and Dutch green bonds versus vanilla adjacents. KBC's green bonds trade modestly through the issuer's non-green bonds, whereas on the Leaseplan curve such tighter spreads are not visible.

Whether technical screening criteria considerations already play a role in these observations remains difficult to say. Factors such as scarcity (ie, fewer green bonds outstanding), size, or alternatives outstanding in the green bond's maturity bucket also play an important role when looking at the relative spreads of green versus vanilla bonds. This may well be the reason why other green bonds issued by Benelux banks are quoted notably less through non-green comparables than the two bonds highlighted.

Besides, the technical screening criteria for climate change mitigation and climate change adaptation are not set in stone yet and will only apply as of 2022. Nonetheless, we do believe that once these criteria are finalised, investors may already start prepositioning themselves by focusing on buying bonds that will allow them to tick the box "taxonomy aligned" to the largest possible extent.

In that regard, Dutch green bonds, including those with proceed allocations towards buildings, could stand to benefit versus other green bonds with building allocations. This would particularly be the case if the technical screening criteria for building assets were to stay as they are in the current Commission proposals. This advantage would clearly diminish with the reintroduction of a 15% best in class approach, which in the end would still be the preferable outcome for the broader green bond market.

Author

Maureen Schuller

Head of Financials Sector Strategy

Maureen.Schuller@ing.com

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Author

Bert Colijn

Chief Economist, Netherlands

bert.colijn@ing.com

Marcel Klok

Senior Economist, Netherlands

marcel.klok@ing.com

Philippe Ledent

Senior Economist, Belgium, Luxembourg

philippe.ledent@ing.com

Mirjam Bani

Sector Economist, Commercial Real Estate & Public Sector (Netherlands)

mirjam.bani@ing.com

Maureen Schuller

Head of Financials Sector Strategy

Maureen.Schuller@ing.com

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