



# Hungary

## External Review of 2020 Green Bond Allocation Reporting

February 18<sup>th</sup>, 2021

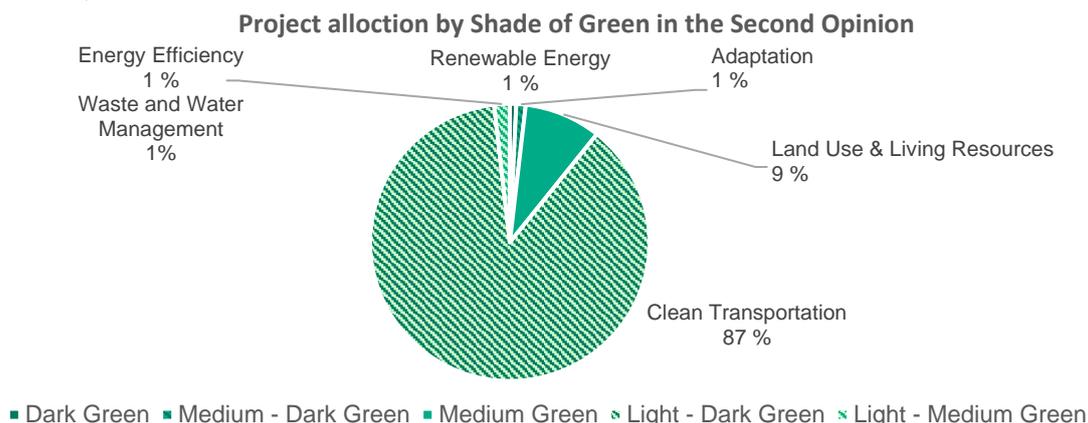
CICERO Green has reviewed Hungary's 2020 Green Bond allocation report. Hungary has also committed to reporting on environmental impacts and expects to release its inaugural impact report in Q4 2021.

**CICERO Green finds no discrepancies in our review of the allocation reporting against Hungary's Green Bond Framework. The reporting is aligned with relevant principles and recommendations for green bond reporting included in the ICMA Handbook, Harmonized Framework for Impact Reporting. Investors should note that proceeds have been allocated to operating expenditures. While these expenditures are eligible under the framework, we encourage further transparency on operating expenditures to be included in impact reporting.**

### Project allocation

Hungary has issued three bonds in 2020, the proceeds from these have been allocated to eligible Green Expenditures from budget year 2018 and 2019<sup>1</sup>. The Ministry of Finance has confirmed that each budget line complies with the green eligible criteria defined in Hungary's Green Bond Framework, including exclusions linked to nuclear power, the armament and defense sector, fossil fuel production and power generation.

The Hungary Green Bond framework was assigned an overall shading of Medium Green in our 2020 Second Opinion. Projects financed therein could encompass all Shades of Green (please see SPO for a detailed review). In the second opinion it was noted that the issuer expected about 90 % of the proceeds to be allocated to clean transportation, which is in line with current allocation.



**Figure 1: Allocation by category. Shading is based on evaluation at time of issuance and does not reflect ex-post project verification.**

The majority of financing has been allocated to the Light to Dark Green category clean transportation<sup>2</sup> (see figure 1) with a majority of proceeds likely allocated to Medium to Dark Green projects with reimbursement of the

<sup>1</sup> Hungary applies the following allocation principle: the amount of Green Bonds issued in a year will be allocated in priority to the older eligible budget years (proceeds can be allocated within the 2 budget years preceding the year of issuance) and receive a proportional allocation of the final year to be allocated. As such, all eligible expenditures from 2018 have been allocated to the bonds, and slightly over half of 2019 eligible expenditures.

<sup>2</sup> The shade of green was assigned in the Second Opinion process, we do not update the shading based on projects financed

operation of the railway network and uncovered costs of railway passenger traffic, investments in electric trains and railway construction. The Medium Green category of Land Use and Living Resources has been allocated 9 % of proceeds. The remaining categories have been allocated approximately 4 % of proceeds.

Investors should note that proceeds have been allocated to investments, tax exemptions intervention expenditures<sup>3</sup> and operating expenditures (e.g., administration costs including salaries for government employees). The reporting informs investors about the allocation break-down for each project category by expenditure type and includes a description of the expenses that have been financed. 26 % of proceeds were allocated to government operating expenditures, which includes personnel costs (ex. salaries for employees in government agencies). Investors should note that the allocation also includes grants to NGOs and subsidies to rail Hungarian operators (e.g. including operating expense and salaries for employees in these organizations). The issuer has confirmed that further detail on the rail related expenditures will be included in the impact report. We encourage further transparency on all operating expenses to be included in impact reporting.

### **Alignment with principles for Green Bond reporting**

CICERO Green reviews the reporting against the relevant principles for allocation reporting in the ICMA Handbook, Harmonized Framework for Impact Reporting<sup>4</sup>. We find that the reporting is aligned with the relevant recommendations and principles. The report includes the amount of proceeds issued, available Green Government Expenditures and amounts allocated. Hungary has a formal process in place for the allocation of proceeds which is described in the Allocation Report and Green Bond Framework. The issuer has confirmed that there were no changes from the expected selection process described in the framework. The issuer has informed us that in the cases where only certain project activities, not the whole project is eligible (partial eligibility), a share equal to the eligible activities has been allocated to green bond funding. They have further explained that there were no controversial cases brought to Inter-Governmental Working Group (IWG) responsible for initial green bond project selection. The reporting lists expenditures by main programmes or schemes, and as such provides detailed information to investors on the nature of expenditures funded. The Euro and Yen exchange rates used are included in the report, providing transparency on the green bond-related cash-flows that are in different currencies.

A core recommendation for good Green Bond reporting is to report on expected and actual environmental impacts at least on an annual basis. Hungary has committed to impact reporting in Q4 2021 including environmental metrics (GHG emissions avoided and project specific metrics).

### **Terms**

CICERO Shades of Green provides a review of Hungary's annual reporting based on documentation provided by the issuer and information gathered during teleconferences and e-mail correspondence. The issuer is solely responsible for providing accurate information. All financial aspects of the sustainable finance reporting- including the financial performance of the bond and the value of any investments in the bond- are outside of our scope, as are general governance issues such as corruption and misuse of funds. CICERO Shades of Green does not validate nor certify the existence of the projects financed and does not validate nor certify the climate effects of the projects. Our objective has been to provide an assessment of the extent to which the bond has met the allocation and reporting criteria established in the 2019 Green Bond framework. The review is intended to inform investors, citizens and other interested stakeholders in the Hungarian Green Bond and has been made based on the information provided to us. CICERO Shades of Green cannot be held liable if estimates, findings, opinions or conclusions are incorrect. Our review does not follow verification or assurance standards and we can therefore not provide assurance that the information presented does not contain material discrepancies.

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<sup>3</sup> Intervention expenditures include grants and loan schemes.

<sup>4</sup><https://www.icmagroup.org/assets/documents/Regulatory/Green-Bonds/Handbook-Harmonized-Framework-for-Impact-Reporting-220520.pdf>



## Detailed Review

Category	Description	Review against framework criteria
Renewable Energy	Subsidized loans for renewable energy use in buildings	<b>No discrepancies found</b> <ul style="list-style-type: none"><li>• The category funds loans for both SMEs and private individuals for a variety of renewable energy projects.</li><li>• Solar and wind (not eligible within 12 km of residential areas) are funded with no additional criteria. Geothermal, biomass and biofuel projects need to demonstrate emissions below 100gCO<sub>2</sub>e/kWh.</li><li>• The SME loans could also include elements of energy efficiency, for example modernization of heating and lighting systems. These projects would likely not qualify for the Dark Green shading. The issuer has informed us that where it was possible to separate out the energy efficiency component of projects this was allocated to the Energy Efficiency category.</li></ul>
Energy Efficiency	Grants to households for energy efficient appliances, tax credits for corporate investments in energy efficiency and support for efficiency measures in agriculture	<b>No discrepancies found</b> <ul style="list-style-type: none"><li>• The grants for appliances require the highest EU energy label. There are no specific efficiency thresholds required to qualify for the corporate tax credits or agricultural efficiency measures.</li><li>• The largest expenditures in this category are related to corporate tax allowances. About half of these investments were in building energy efficiency, a small share of investments were related to plastics and heat recovery. A third of the SMEs financed are in car repair and are therefore exposed to transition risks as we transition to more electric vehicles requiring less and different types of repair services.</li><li>• The investment expenditures include elements of renewable energy and clean transportation, specifically electric vehicles.</li></ul>
Land Use and Living Natural Resources	Broad range of projects including national parks, support for civil society and sustainable agriculture	<b>No discrepancies found</b> <ul style="list-style-type: none"><li>• The largest share of expenditures in this category is support to sustainable agriculture.</li><li>• The category includes funding for the Herman Otto Institute, a state-owned organization that focuses on eco-label certification, environmental protection, nature conservation and agricultural training<sup>5</sup>. Funding has also been allocated to NGOs for environmental projects. Funded projects and amounts are publicly available<sup>6</sup>.</li><li>• This category also includes support to supports for national park directorates, including operating expenditures. The reporting includes a description of the nature of expenditures, but no detailed breakdown of operating expenses. We encourage further transparency on</li></ul>

<sup>5</sup> More information about the institute <http://www.hermanottointezet.hu/> and <https://www.parlament.hu/irom41/10710/adatok/fejezetek/12.pdf>

<sup>6</sup> Projects related to the expenditures 3.3.3. Education, awareness raising (Implementation of the National Environmental Protection Programme) are available on the government.hu website after the funding decision has been made: <https://2015-2019.kormany.hu/hu/foldmuvelesugyi-miniszterium/parlamenti-allamtitkarsag/hirek/a-2020-evi-zold-forras-palyazat-eredmenye> Projects related to the expenditures 3.3.5. Others ((Protection of environmental media) and (Support of environmental projects) are also available on the government.hu site. All contracts concluded by the ministries are published on a monthly basis, as follows: <https://kormany.hu/dokumentumtar/szerzodesek-2022>

		<p>operating expenses, and we expect the impact report to also shed further light.</p> <ul style="list-style-type: none"> <li>• A small share of financing has been allocated to other projects, including noise mapping, which were not listed in the framework, but fit well with the category objectives and definition.</li> <li>• The category has been allocated slightly more funding than anticipated prior to issuance (9 % vs. 5 %)</li> </ul>
Waste & Water Management	Improvements of wastewater and water infrastructure, support for waste management, circular economy and other projects	<p><b>No discrepancies found</b></p> <ul style="list-style-type: none"> <li>• The two largest expenditures in this category are support for water utilities and plastic waste recovery activities at Remat Zrt.</li> <li>• This category funds several innovative circular economy initiatives. Among them the The Irinyi plan which brings together Hungary's industrial development ideas related to the green economy and the transition to a circular economy.</li> </ul>
Clean Transportation	Construction of railways, light rail, purchase of rolling stock and other rail related projects	<p><b>No discrepancies found</b></p> <ul style="list-style-type: none"> <li>• Hungary confirms to exclude operating expenditures related to diesel fuel. All rail guided vehicles finance in this category are electric and investments into fossil fuel carrying freight trains are not eligible.</li> <li>• 76% of this category were allocated to Reimbursement of the operation of the railway network and Reimbursement of uncovered costs of railway passenger traffic based on EU directive, which includes administrative costs such as personnel costs (among them salaries to nearly 20.000 employees) and fossil fuel powered maintenance equipment costs as well as purchase of electricity from the national grid. The reporting includes a description of the nature of expenditures, but no detailed breakdown of operating expenses. We encourage further transparency on operating expenses incl. personnel costs, and we expect the impact report to also shed further light.</li> <li>• The issuer confirmed that the heat source of the train station financed is provided by a heat pump.</li> <li>• We note that the majority of the share of proceeds were allocated to Medium to Dark Green projects. As mentioned in the Second Opinion: while marginal compared to the total investments under this category CNG busses and respective construction of filling stations were financed under this category</li> </ul>
Adaptation	Infrastructure to enhance resilience to natural hazards. Improved data, capacity and monitoring, support for the meteorological service	<p><b>No discrepancies found</b></p> <ul style="list-style-type: none"> <li>• The majority of funding in this category has been allocated to the water level rehabilitation of the Mosoni-Danube. According to the issuer there was a process in place to consult with local stakeholders and the neighboring Sovereign.</li> </ul>



## Appendix 1: About CICERO Shades of Green

CICERO Green is a subsidiary of the climate research institute CICERO. CICERO is Norway's foremost institute for interdisciplinary climate research. We deliver new insight that helps solve the climate challenge and strengthen international cooperation. CICERO has garnered attention for its work on the effects of manmade emissions on the climate and has played an active role in the UN's IPCC since 1995. CICERO staff provide quality control and methodological development for CICERO Green.

CICERO Green provides second opinions on institutions' frameworks and guidance for assessing and selecting eligible projects for green bond investments. CICERO Green is internationally recognized as a leading provider of independent reviews of green bonds, since the market's inception in 2008. CICERO Green is independent of the entity issuing the bond, its directors, senior management and advisers, and is remunerated in a way that prevents any conflicts of interests arising as a result of the fee structure. CICERO Green operates independently from the financial sector and other stakeholders to preserve the unbiased nature and high quality of second opinions.

We work with both international and domestic issuers, drawing on the global expertise of the Expert Network on Second Opinions (ENSO). Led by CICERO Green, ENSO contributes expertise to the second opinions, and is comprised of a network of trusted, independent research institutions and reputable experts on climate change and other environmental issues, including the Basque Center for Climate Change (BC3), the Stockholm Environment Institute, the Institute of Energy, Environment and Economy at Tsinghua University and the International Institute for Sustainable Development (IISD).

