

Net Zero Banking Alliance Intermediate Targets

Basis of Preparation

September 2023



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BACKGROUND

Climate change and its impacts remain the most pressing challenge facing our planet.

OSB Group is a leading specialist mortgage lender, primarily focused on carefully selected sub-segments of the mortgage market such as Buy to Let, Residential (including Help to Buy and shared ownership), complex commercial and semi-commercial, development finance, bridging and asset finance. **We do not lend to, or invest in the fossil fuel industry.**

Stewardship is a core value of the Group which means that we act with conscience and take social, environmental and ethical factors into consideration at all times.

Our environmental ambitions and in particular our response to climate change is well aligned to our purpose of helping our customers, colleagues and communities prosper. Acting with conscience means that we are committed to doing the right thing by our stakeholders which includes the environment.

In 2022, OSB Group (the Group) pledged to tackle the operational emissions from our offices and branch buildings and the more challenging emissions associated with the properties we lend on - our financed emissions.

Furthermore we stated our ambition to achieve net-zero emissions across wider business activities by 2050 in line with the ambitions of the Paris Climate Accords of limiting global warming to well below 2°C and pursuing efforts to limit it to 1.5°C.

Though much detail remains still to be defined in the UK government's pledge to cut greenhouse gas emissions, we believe it's critical to make such pledges and to take a committed stance. It is through such pledges and commitments supported by emerging regulation, that organisations such as ours will determine roadmaps towards achieving these ambitious targets.

Recognising that for any business to achieve net zero it will need the collaborative support from key stakeholders across industry and beyond, including policy makers, the Group joined the United Nations Net Zero Banking Alliance (NZBA). Through this membership the Group joined other financial services organisations in committing to transition the operational and attributable Greenhouse Gas (GHG) emissions from their lending and investment portfolios to align with pathways to net-zero by 2050 or sooner and setting 2030 targets (or sooner) and a 2050 target.

At the core of this commitment is the acceptance of climate science demonstrating that in order to limit warming to 1.5°C with no or limited overshoot, "rapid, deep and, in most cases, immediate greenhouse gas emissions reductions in all sectors this decade" are required.

This document includes our first interim net zero target for financed emissions and details the basis upon which it has been prepared. In setting targets we have referenced the NZBA Guidelines for Target Setting for Banks and the SBTi Financial Sector Science Based Targets Guidance.

We expect that we will revisit these targets and the scenarios upon which they are based with some regularity as further developments in climate science, government policy, technology and innovation mature over time. We will also consider setting additional targets to cover other areas of the Group's total value chain in due time.

Work is currently underway in developing the Group's first Climate Transition Plan which will set out our wider climate ambitions and targets, the steps we are taking and intend to take, and how we are establishing transition thinking and planning within our business model. This first step of target setting is a key aspect that will be included within the Transition Plan.

UK BUILDINGS AND NET ZERO

In September 2022 the UK government launched an independent net zero review, with the purpose of identifying how the UK could meet its legally binding net zero commitments by 2050 in an affordable and efficient manner. The review concluded that "the UK should be proud of the steps it has taken so far to achieve net zero". However, it stated that "government, industry, and individuals need to act to make the most of the opportunities, reduce costs, and ensure we deliver successfully." A number of the recommendations to the government from the Skidmore review are vital to the Group achieving its ambitions and climate targets.

The financial services sector provides funding for assets that produce varying levels of greenhouse gas emissions. Although the Group's mortgage lending is via intermediaries, we accept that we have a role to play in supporting them and their customers towards the UK's net-zero ambition, as the UK housing market currently contributes around 17% of all the carbon dioxide emissions in the UK. However, as a mortgage lender without direct control over the buildings we lend on, there are material dependencies on external actors and their control and influence.

There is significant uncertainty over the Government's policies relating to the UK's housing stock. In the Powering Up Britain report published in March 2023, the government said, "We remain committed to improving energy efficiency performance across different buildings. We are planning to consult by the end of this year on how to improve the energy efficiency of owner-occupied homes. We will publish a summary of responses to the consultation on improving the energy performance of privately rented homes and respond to the consultation on improving home energy performance through lenders".

The government's consultation on minimum energy performance standards for Private rented homes took place in 2020, and responses are yet to be published. The proposed milestones at 2025 and 2028 now appear unlikely, with 2028 now considered a more likely first step. The second reading of the Minimum Energy Performance of buildings Bill through parliament in late March 2023 proposed new tenancies to achieve EPC Band C by 31st December 2028 (previously 2025). Such delays, whilst welcome if delivering due consideration to the impact on homeowners, landlords and their tenants, will likely delay investment and therefore the rate of decarbonisation the Group will realise.

FINANCED EMISSIONS

The Group are committed to aligning our financing to the goals and timelines of the Paris Climate Accord, limiting the increase in global temperatures to 1.5°C and achieving net zero by 2050.

We have estimated and disclosed the financed emissions (scope 3 category 15) from our mortgage lending since 2021 using the Partnership for Carbon Accounting Financials (PCAF) Methodology. Using this methodology allows for a standard, transparent and comparable method of calculating and disclosing emissions estimates across the sector.

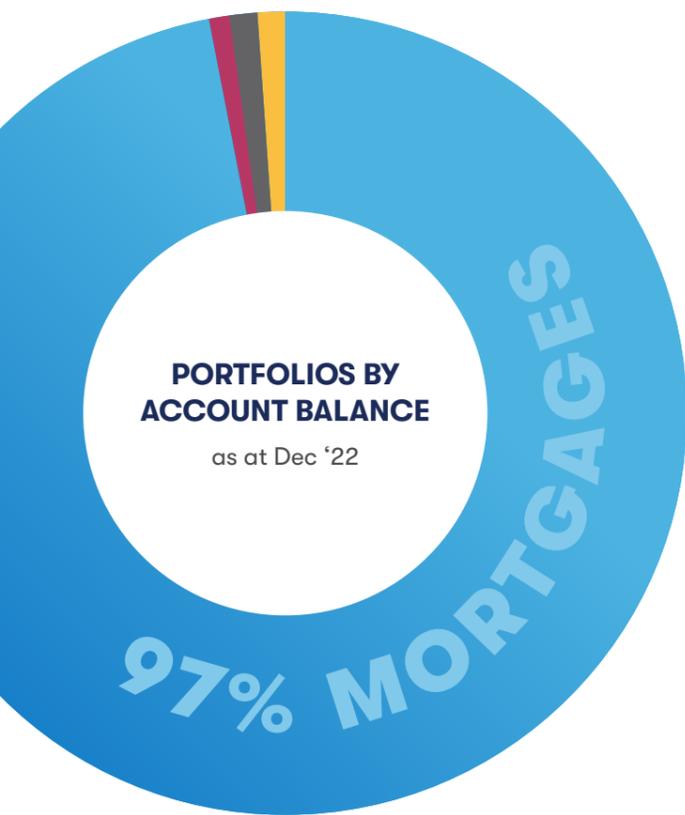
¹ <https://lordslibrary.parliament.uk/mission-zero-independent-review-of-net-zero/#heading-2>

² https://assets.publishing.service.gov.uk/government/uploads/system/uploads/attachment_data/file/1128689/mission-zero-independent-review.pdf

³ https://assets.publishing.service.gov.uk/government/uploads/system/uploads/attachment_data/file/1147372/2022_Provisional_emissions_statistics_report.pdf

⁴ https://assets.publishing.service.gov.uk/government/uploads/system/uploads/attachment_data/file/1147340/powering-up-britain-joint-overview.pdf

⁵ <https://carbonaccountingfinancials.com/files/downloads/PCAF-Global-GHG-Standard.pdf>



SECTOR BOUNDARIES

Over 97% of the Group’s account balances in 2022 was in the form of mortgages, within owner occupier and buy-to-let residential and semi-commercial and commercial property. As a sub-sector specialist lender, mortgage lending is our primary area of business activity and where our initial target has been established.

Over time the Group will assess the emissions of other portfolios. These segments contribute the remaining 2.7% of account balances. In comparison these portfolios are not considered material, and whilst emissions estimates have not been carried out, it would not be expected that they contribute materially to the Group’s emissions baseline.

- Mortgages
- Asset Finance
- Bridging
- Funding lines

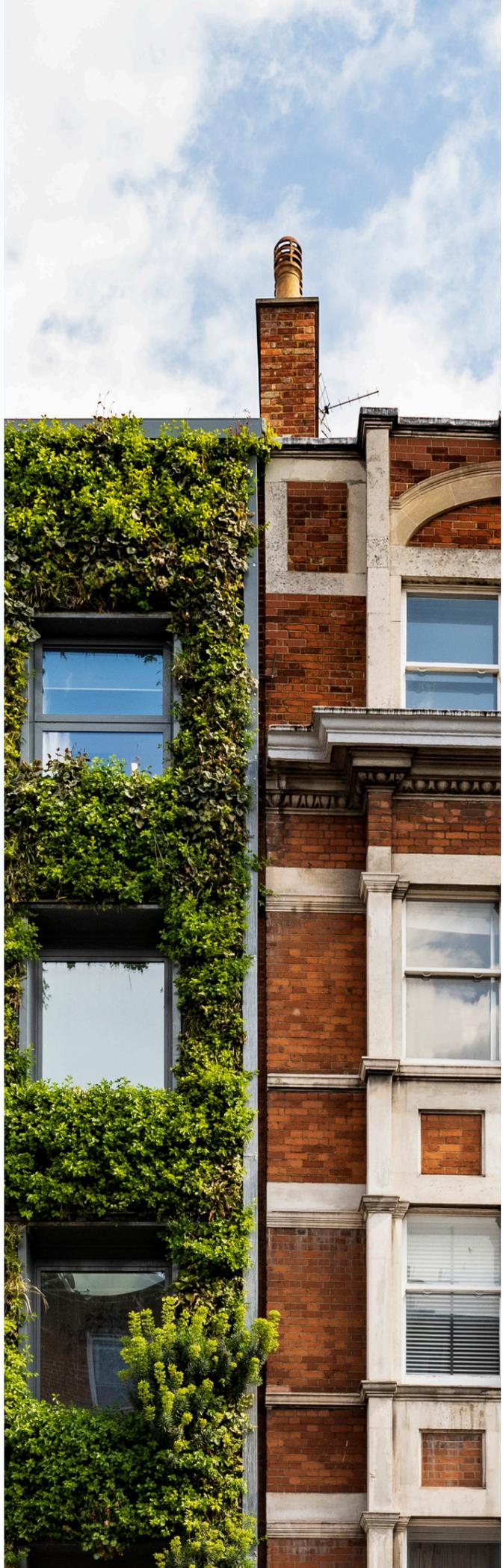
EMISSIONS SCOPE

We use the GHG Protocol to define emissions sources within Scope 1, 2 & 3. Within Scope 3 – our indirect emissions – we prioritise the most material sources of emissions for calculation and target setting. In determining priorities for calculation and target setting, we consider the materiality of the emissions source to our business, the availability of a credible framework for measurement and reporting, data availability and integrity, and the level of control or influence we have over them. We expect that in line with the GHG protocol our emissions calculations in Scope 3 will become increasingly accurate over time.

In 2023 we completed a Scope 3 emissions materiality assessment, the results of which estimate that category 15 – investments, accounts for around 96.7% of the Group’s total emissions.

We report metrics and targets in CO₂e (carbon dioxide equivalent). This is in line with the Net Zero Banking Alliance guidance. We report Scope 1 and Scope 2 emissions related to the regulated energy use (space and water heating, lighting and ventilation) of a property financed through the mortgage, and the emissions attributed to the Group are calculated using PCAF methodology.

The Group does not lend into other carbon intensive sectors as defined by NZBA guidance which include agriculture, aluminium, cement, coal, iron and steel, oil and gas, power generation, or transport.



TARGET METRICS

For mortgage lending we use the physical intensity metric of CO₂e/m² for target setting and ongoing monitoring. This is consistent with PCAF and NZBA Guidance, that financial institutions should consider reporting physical emission intensities using sector-specific activity where relevant to business goals.

A physical intensity metric is considered appropriate to mortgage lending as the energy efficiency of a property is material to its energy consumption, with per m² providing a normalised metric against which a comparison between properties can be made.

CLIMATE SCENARIO SELECTION

Our target has been developed with reference to a 1.5°C aligned scenario. For our initial target for mortgages, we have used the UK’s Climate Change Committee Balanced Net Zero Pathway (CC BNZP) as a UK specific scenario that is built around the UK’s ambition to reach net zero by 2050 by decarbonisation of the largest polluting sectors including buildings and is from a credible and independent institution.

As a specialist lender, it is important to us that we select credible and relevant climate change scenario’s that consider sector activities relevant to our business activities and provides credible insight of progress and the challenges faced in decarbonising UK housing. We have also considered the requirements of the NZBA, and our overarching ambition of net zero by 2050 when selecting a scenario.

A number of scenarios were analysed against set criteria. The outcome of this analysis, is that we selected the CCC BNZP from which to set our financed emissions interim (2030) and long term (2050) net zero targets. This scenario balances expected reductions across multiple sectors, including a specific pathway for buildings that we feel is best representative of likely actions over time.

BASELINE YEAR

We have selected 2022 as our baseline year for our mortgages science based target. 2022 provides the most accurate estimate of emissions conducted to date and is in line with our ambition to improve the quality and coverage of data used within our PCAF calculation over time.

⁶ As at Dec 2022

⁷ As at Dec 2022

⁸ <https://ghgprotocol.org/sites/default/files/standards/ghg-protocol-revised.pdf>

ESTIMATING FINANCED EMISSIONS

Date coverage, quality and estimates

In estimating the emissions from our mortgage lending, we have used the PCAF methodology for mortgages. This is a well-established approach and allows for improvement over time, based on the availability and accuracy of the data source. A data quality score is calculated based upon the quality and accuracy of the data used.

In the PCAF calculation, a proportion of the building's annual emissions are attributed to the mortgage provider using the loan-to-value of the mortgaged property. Thus, the attribution is equal to the ratio of the outstanding balance at the time of GHG accounting to the property value at the time of loan origination.

Financed emissions for mortgages are calculated by multiplying the attribution factor by the emissions of the building.

Our financed emissions calculations rely on externally sourced data. In our 2022 baseline calculation, the emissions of the building were taken, where available, from Energy Performance Certificates (EPC's) which estimate the carbon emissions of a property. In 2022 79.9% of properties had a valid EPC certificate. 19.7% of properties had emissions modelled or estimated based on postcode average or UK average. The calculation does not include non-modelled book or securitised loans. The properties floor area (m²) is also taken from the EPC certificate allowing for the calculation of the intensity ratio kgCO₂e/m².

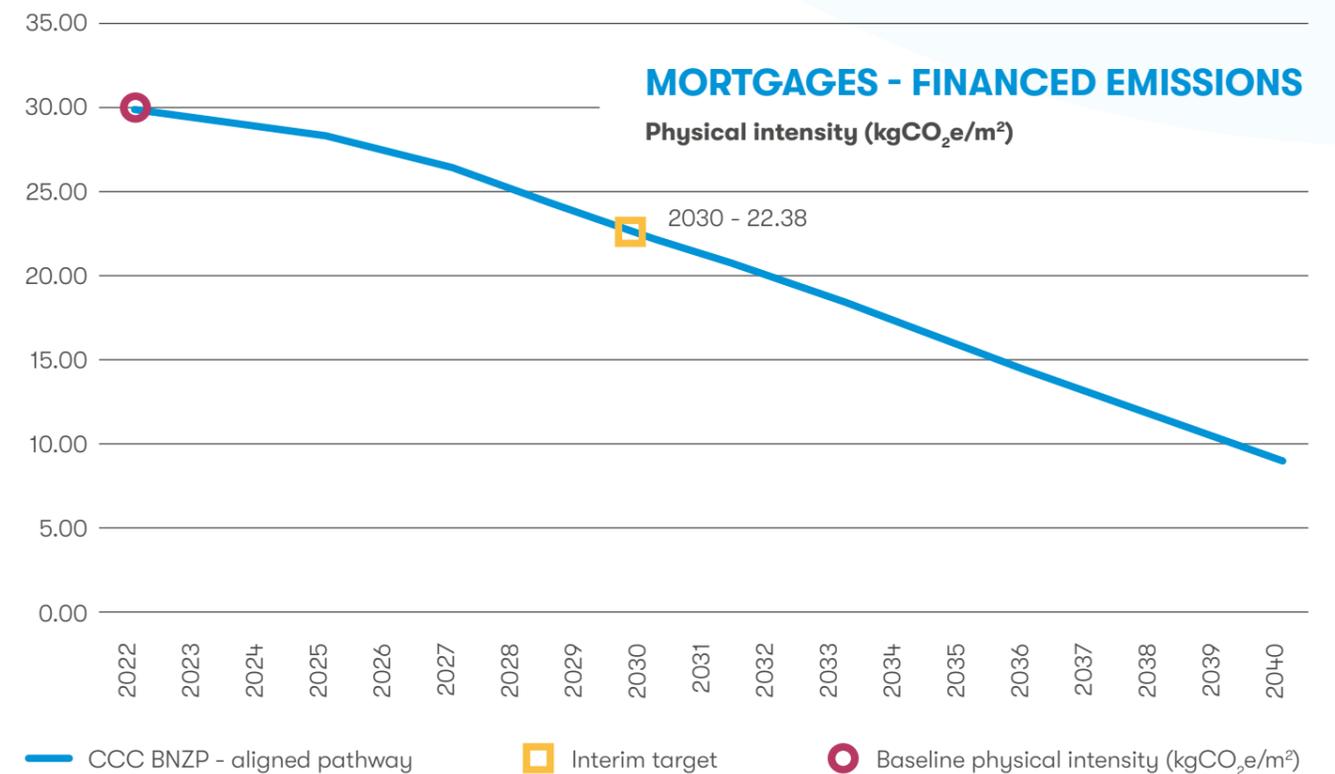
There are inherent limitations in using Energy Performance Certificates to calculate financed emissions such as the time lag for external data sources being updated, the age of certificates - up to 10 years old, and the methodology failing to prioritise carbon neutral over fossil fuel based technologies.

INTERMEDIATE NET ZERO TARGET FOR MORTGAGES

Financed emissions contributed 363,680.00 tCO₂e to the Group's inventory in 2022. This represents 96.7% of total emissions for the Group and the most material source within the Group's inventory. The financed emissions category represents the Group's mortgage lending activities covering the buy-to-let and residential mortgages and commercial and semi-commercial mortgage lending. These segments contribute 97.3% of total account balances.

Decarbonising UK housing stock is a complex and challenging task, one that will require widespread engagement and ultimately systemic change to how energy is generated and distributed and how home owners heat, cool and power their homes.

In line with the CCC BNZP scenario our mortgage portfolio would need to reach an emissions intensity of 22.38kgCO₂e/m² by 2030 against a 2022 baseline of 29.93kgCO₂e/m² to be on the trajectory to net zero by 2050. This is the equivalent of a 25% intensity reduction by 2030.



GOVERNANCE

The highest executive level of the Group approve emissions reduction goals and targets and they are reviewed by the highest-level governance body in the bank. The Board delegated the day-to-day management of climate risk to the CEO, who is assisted by the ESG Technical and Group Executive Committees in discharging these responsibilities. In addition to its direct oversight, the Board delegate's responsibility for the Group's climate related risk appetite, risk monitoring, provisioning, and capital and liquidity management to the Group Risk Committee.

Our science based targets have been through a defined governance route, with scenario selection and subsequent targets discussed at ESG Technical Committee, Group Executive Committee and ultimately reviewed by the Board.

Progress against the targets will be monitored regularly by ESG Technical Committee, Group Risk Committee and Group Executive Committee and presented to the Board.

REPORTING

We will report progress against our targets externally on an annual basis, within our Climate-related Financial Disclosures. As part of our Climate Transition Plan development we are considering additional metrics that relate to the actions we are taking or plan to take towards achieving our ambitions.

REVIEWING OUR TARGETS

We expect that we will review our targets more regularly, but as a minimum we will review the intermediate science-based target, every five years.

As methodologies mature, data access challenges are overcome or stakeholder expectations change, we may choose to revisit how targets are set.

OPERATIONAL EMISSIONS

This document focuses on the Group's targets for financing activities and the commitments we made through membership of NZBA. It is recognised that whilst financed emissions contribute to the majority of emissions to our inventory, the emissions from the buildings we operate from must also be reduced. The Group has committed to addressing these emissions and in doing so have established a target to:

Reduce Scope 1 and Scope 2* emissions to net zero by 2030 from a 2022 baseline.

Further details, including how we plan to meet this will be included in our Climate Transition Plan.

*Based on Market-Based methodology



FUTURE CONSIDERATIONS

The Group also committed to the Science Based Targets initiative (SBTi) in 2022. As SBTi guidance for financial institutions evolves at pace, with a new Net Zero Financial institution standard expected by the end of 2023, interoperability will need to be considered, as will the consideration of future targets as they relate to the Group's wider Climate Transition Plan, which is currently in development.

We have limited control and influence over a number of key practical factors that will contribute to, or limit, the levels of decarbonisation of our mortgage portfolio by 2030. Progress relies on a stable government policy framework and consumer knowledge, appetite and affordability of investing in their properties. Cross industry action that considers the interrelated challenges to support consumer decision making and investment is vital. The Group remain committed to a considered and customer centred approach to decarbonisation and cognisant of the risk of unintended consequences associated with a penal approach to achieving our ambition.

The Group are committed to maintaining our participation in initiatives and joining others that encourage government action to support the transition towards a low carbon housing economy and driving real economy change.

Internal research has identified the following external factors as key influences on our ability to achieve our targets:

Energy Grid decarbonisation

The UK's electricity mix will acquire a significant additional amount of renewable energy input as the UK government attempts to maintain its commitments to decarbonise the grid by 2035. The Committee on Climate Change (CCC) has identified in the Next Steps for UK Heat Policy, that electrification of heat supported by low-carbon power generation is the most likely prediction. However "at the current pace of change, the UK is set to fail to hit its target of decarbonising the power sector by 2035".

Pace of retrofitting the UK's existing housing stock

Having understood the important external challenges to retrofitting such as; trade capacity, manufacturing, cost, practicalities and knowledge, it is clear that government direction and clarity would be beneficial in all of these areas of the retrofit supply chain. Effective government action and direction on retrofitting will determine the pace at which industry scales and the UK's existing housing stock can be decarbonised.

Technology

Technological innovation is a significant factor that will impact the rate of domestic energy source decarbonisation. Improving grid capacity ahead of heat pump uptake will be vital as electrification of heat will put significant additional pressure on the UK's electrical network. Additionally heat pump technology designed with the UK's climate and aging housing stock in mind will be important to achieve large scale deployment.

Minimum Energy Efficiency Standards

For customers to take action, appropriate and stable government policy, incentives and penalties are essential such as raising the minimum EPC ratings for commercial and private rented sector buildings.

Heat and Buildings Strategy¹⁰ and the Futures Homes Standard¹¹

Increasing the energy efficiency standards of new build homes and the commitment to reaching a market capacity of 600,000 heat pumps installed a year by 2028.

Cost

Payback periods on retrofitting and net zero technologies such as heat pumps often extend over a number of years. This may prevent some landlords and homeowners investing if the return on investment extends beyond their intended term of ownership.

Education

Increasing consumer awareness of climate change and the need to take action could encourage consumers to choose net zero technologies or to invest in retrofitting at specific trigger points such as when their current gas boiler is due for replacement.

In 2022 the Group launched its Landlord Leaders thought leadership program and community with the intention of understanding the changing shape of the Private Rented Sector through an ESG lens. In order to help shape our strategy, support our broker partners and deliver the support our landlord clients need today and looking forwards. In 2023 the Landlord Leaders community brings together brokers, landlords and other industry members to develop a collective manifesto for change.

Should government policy fall short of net zero commitments, or consumer action remain limited, there will be a need for additional policy intervention for the government to deliver its legally binding net zero targets.

USE OF CARBON OFFSETS

We are committed to taking action to reduce emissions and do not recognise carbon offsets as contributing to our net zero ambitions and targets. We have not offset Scope 3 category 15 emissions.

Since 2021, the Group have used carbon offsets from a limited number of third party schemes from the Voluntary Carbon Market (UN Clean Development Mechanism, Verra - Verified Carbon Standard or Gold Standard) to offset operational emissions in Scope 1 and Scope 2 and a limited number of Scope 3 categories related to our operational activities.

We intend to continue to use offsets to mitigate operational emissions that are yet to be eliminated. The use of offsets is not part of our intermediate science-based target.

¹⁰ https://assets.publishing.service.gov.uk/government/uploads/system/uploads/attachment_data/file/1044598/6.7408_BEIS_Clean_Heat_Heat_Buildings_Strategy_Stage_2_v5_WEB.pdf

¹¹ https://assets.publishing.service.gov.uk/government/uploads/system/uploads/attachment_data/file/956094/Government_response_to_Future_Homes_Standard_consultation.pdf

¹² <https://www.gov.uk/government/news/plans-unveiled-to-decarbonise-uk-power-system-by-2035>

¹³ <https://www.theccc.org.uk/publication/next-steps-for-uk-heat-policy/>



