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This document describes HR Rating's Social Bonds Evaluation Criteria (SBEC), which represent the process by which a Social Level is assigned to different financial instruments, which can be grouped under the Social Bonds concept. It's important to note that this document does not provide a process whereby the result is a credit rating, rather it represents an assessment of the social impact a specific project or asset may have over time. This document establishes a scale to classify different projects related to Social Bonds. Therefore, the main objective of the SBEC, and the resulting level, is to provide market participants, interested in investing in this type of asset, with information to classify different Social Bonds according to the social impact expected from projects financed with the captured resources, and the capacity of the issuer to comply with international standards of transparency and reporting.

These criteria incorporate internationally recognized concepts for the assessment of Social Bonds, such as the Sustainable Development Goals (SDG) that form part of the United Nations Development Program (UNDP)¹ and the Social Bond Principles (SBP)². These two globally accepted directives establish clear criteria for the assessment of social projects, and policies on generating and disseminating information to contribute to the development of the Social Bonds market. The SBEC is divided into a two-part analysis. The analytical process is based primarily on qualitative aspects of these projects, and an assessment of the type of information the issuer generates. However, where possible, the criteria may also include quantitative indicators. It's important to mention that the SBEC consider a Preliminary Phase for both initial evaluations and subsequent reviews, where it is determined whether the legal documentation for the instrument clearly shows the adoption of the SBP and defines the social project or asset subject of the financing, in the sense that the project or asset does and/or could contribute to improving social wellbeing or development. If this is not the case, HR Ratings will not initiate the evaluation process.

The first stage of the evaluation process consists of a social analysis, where HR Ratings will analyze the project's proposed solutions that aim to address a certain social problem and/or achieve some positive social result. This is determined according to the contribution to one or more of the 169 goals established in the UNDP Sustainable Development 2030 Agenda. These goals were proposed in the 17 SDG which advocate the eradication of poverty, promotion of prosperity and wellbeing for all people, protection of the environment, and the fight against climate change. The second stage consists of an assessment of the issuer's capacity to comply with each of the SBP.

The result of the SBEC is a Social Level that contains two elements. First, a three-level scale that represents the type of solution to a social problem and its level of impact on the population. Second, another three-level scale that represents the degree of compliance with the SBP. Then, the final Social Level is a nine-notch scale that clearly indicates the results of each of the analyses. The Social Level assigned corresponds solely to the analysis applied now in which HR Ratings makes the evaluation public.

¹ The UNDP is part of the United National Development Group (UNDG) and is present in 170 countries and territories, working to eradicate poverty and reduce inequality and exclusion.

² The SBP are a series of internationally accepted standards developed by the International Capital Market Association (ICMA), a group of financial institutions that supports and promotes the development and efficient operation of the global capital markets.

Introduction

The ICMA defines Social Bonds as a financial instrument to raise funds that will be used exclusively to finance or refinance, in whole or in part, new and/or existing social projects with the potential to produce positive effects for a population. The four principles described in the SBP³ must be satisfied for the ICMA to recognize a bond as social. Additionally, the ICMA has identified four types of Social Bonds (BS).⁴

Social Bonds may be issued by corporates, financial institutions, development banks, governments and trusts (in the case of asset-backed debt). Because of the latter, Social Bonds may not be limited to being secured obligations, they may also be issued to finance a new project with no historic record (project finance), bonds without recourse to issuer, and bonds backed by a portfolio of assets.

The assets, projects or activities analyzed with these criteria must seek a social benefit, such as fighting poverty or hunger, access to healthcare, access to different services, remunerated employment, gender equality, eradicating inequality, promoting strong institutions, etc.⁵

To determine whether a project has the potential to generate social development or wellbeing, HR Ratings will assess the degree to which the project complies with one or more of the goals set in the Sustainable Development 2030 Agenda, signed in September 2015 at the United Nations Sustainable Development Summit in New York. The 2030 Agenda is comprised of the 17 SDG and their 169 goals to be achieved by 2030, which propose measures for reducing poverty, protecting the planet, and ensuring that all people enjoy prosperity, among others. HR Ratings recognizes that these are not necessarily the only goals with the potential to generate a positive social impact, although, without doubt, they do provide a starting point.

The HR Ratings SBEC assign a social level to Social Bond debt instruments where the proceeds are used to finance or refinance projects with a positive impact on social development. Meaning, physical assets that contribute to the Sustainable Development 2030 Agenda or other goals to benefit social wellbeing. Additionally, these bonds must comply with the four SBP of the ICMA, as detailed below.

It's important to note that the SBEC are not a credit assessment of the issued bonds. The Social Level is independent of the ability and willingness to pay of the issuer and the financial instrument itself. That HR Ratings may or may not issue a credit rating for this type of bond does not limit or restrict HR Ratings from assigning a Social Level.

The Preliminary Phase determines whether the legal documentation for the bond clearly shows the adoption of the SBP and defines the social project or asset subject of the financing, in the sense that the project or asset does and/or could contribute to improving social wellbeing or development. If this is not the case, HR Ratings will not initiate the evaluation process.

The first stage of the process identifies the goal or goals of the project and measures the potential social impact. It's important to mention that this impact will be quantified where possible. Therefore, the level assigned will largely be built from a qualitative analysis. This part of the analysis focuses on the capacity of the project not only to generate social

³ "The Social Bond Principles 2017", ICMA, June 2, 2017.

⁴ A more detailed explanation of each type of bond is provided in Appendix II.

⁵ Certain social projects may also have an environmental benefit. These types of projects, having both green and social goals, are known as Sustainable Bonds.

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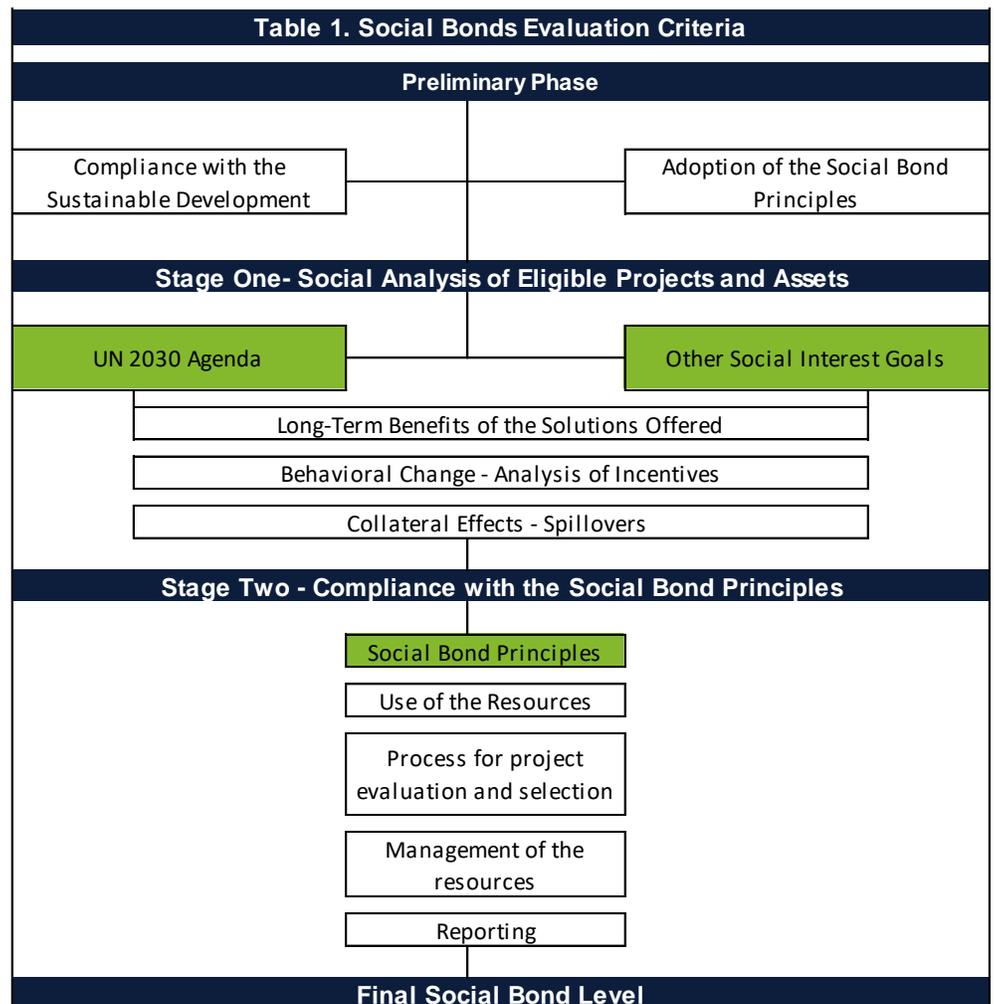
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wellbeing, but also to offer permanent solutions that do not lead to undesirable behaviors in the target population or have adverse collateral effects. This refers to an analysis of incentives and spillovers, which, as the project permits, HR Ratings may measure through quantitative techniques.

Stage two focuses on compliance with the SBP, which are:

- 1) Use of resources;
- 2) Process for project evaluation and selection;
- 3) Management of resources;
- 4) Reporting.

Table 1 summarizes the Preliminary Phase and the two analysis stages of the HR Ratings Social Level Evaluation process.



Source: HR Ratings

Process for the assignment of the Social Level

Preliminary phase

As mentioned, the SBP are directives that promote international best practices in terms of transparency and dissemination of information, and reliability in the process for issuing and monitoring Social Bonds. However, in addition to this, the United Nations (UN) has presented its 2030 Agenda for Sustainable Development, which sets goals by which the different assets or activities that may be associated with Social Bonds can be identified.

HR Ratings considers this set of criteria to be the best reference for identifying whether the funds will be used for a project or a portfolio of projects related to improving the social wellbeing. By consequence, to assign the Social Level for a bond, HR Ratings must first verify whether the project satisfies one or more of these criteria, which are desirable to generate a social benefit, and verify that the legal documentation for the bond clearly, precisely, and fully shows the adoption of the SBP.

In summary, all eligible and qualified social projects must, with the resources generated from the placement of the bond, deliver clear social benefits that can be evaluated and, where feasible, quantified. Regardless, this benefit must translate into a positive socioeconomic impact for a population or for a certain group of people.⁶ Some examples of this type of project are: 1) development of basic infrastructure, 2) access to essential services, 3) affordable housing, 4) job creation programs, 5) support programs for small and medium companies, and 6) food security, among others.

Stage One: Social analysis of projects and eligibility criteria

Once HR Ratings has verified that the bond or the instrument satisfies the preliminary phase, the first stage of the assessment consists of analyzing the capacity of the project or framework to improve the development or wellbeing of the population, in the sense of mitigating or addressing a certain social problem. HR Ratings must continually monitor that each project complies with one or more of the goals set out in the UN 2030 Agenda.⁷

Although this agenda is extensive, it is recognized that it may not cover all areas that advocate social wellbeing and development in a region, therefore these SBEC also look at activities with a positive impact on social wellbeing not considered in the goals of the 2030 Agenda.

The analysis in this stage is primarily qualitative. A social project may have multiple goals, or may focus on just one, with a positive net social effect expected. As mentioned, a quantitative analysis of the social cost-benefit expected from the project will be conducted where possible.

It's important that the project does not offset the impact of other objectives to achieve a specific goal. For example, a project that effectively fights poverty in the short term may have the negative effect of increasing inequality in a certain region or within a certain income percentile. This could hinder the development of the local institutions and, in turn, have adverse effects on poverty in the long term. In this case, it may not be possible to develop a measure that would quantify the expected loss for the region or decile involved,

⁶ The social groups that may be identified include: 1) differently abled persons, 2) persons exposed or vulnerable to natural disasters, 3) migrants, 4) unemployed, 5) illiterate persons, etcetera.

⁷ HR Ratings is aware that the time it will take to achieve a goal, and its level of social impact, will vary depending on each project. Despite this, the scopes and objectives must always be clearly expressed and defined in the legal documentation.

but the qualitative analysis would identify red flags that would be incorporated into the final Social Level given by HR Ratings.

HR Ratings will assess the social benefits of the project according to the following criteria.⁸

- i) The capacity of the project or the framework to offer permanent solutions. There is a risk that the region or population will receive a temporary benefit, but that the situation will worsen again when the project has ended.
- ii) The project or the framework generates favorable incentives for society, without adversely modifying the behavior of the target population. The project may generate perverse incentives that could be exploited by different agents and which would diminish the social benefit in the long term.
- iii) The project or the framework may generate spillovers or have collateral effects, positive or negative, within or outside the target region or population.

United Nations 2030 Agenda Goals⁹

Table 2 presents the 17 SDG. If a project addresses one or more of these, it is eligible to be rated by HR Ratings.

Table 2. Eligible Social Projects

Poverty	Reduced Inequalities
Hunger	Sustainable Cities and Communities
Health and Wellbeing	Responsible Consumption and Production
Quality Education	Climate Action*
Gender Equality	Life below Water
Clean Water and Sanitation	Life on Land
Affordable and Clean Energy	Peace, Justice and Strong Institutions
Decent Work and Economic Growth	Partnerships for the Goals
Industry, Innovation and Infrastructure	

* HR Ratings will use the Green Bonds Evaluation Criteria (GBEC) when the benefit of the project is to reduce CO₂ emissions.

Source: HR Ratings

⁸ HR Ratings will hold all projects to these criteria during this first stage.

⁹ For more information on the SDG, visit: <http://www.un.org/sustainabledevelopment>

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On the one hand, it's important to mention that when the project or the framework offers only environment-related benefits or goals, HR Ratings will determine whether the associated bond should be treated as Social or Green. In the case of the latter, the Green Bonds Evaluation Criteria will apply.¹⁰ On the other hand, these objectives and/or goals are particularly sensitive to the context of the project. Meaning, not all countries or regions share the same definitions of poverty, health, wellbeing and development. Different regions may have diverse cultural aspects that could produce different results for similar projects.

For example, poverty traps are common, and they are usually related to the cultural characteristics of a region. HR Ratings will assess whether the project offers partial solutions in the short term that would have adverse effects on the social wellbeing in the long term, on altering functional social dynamics. The project must favor countering social inequality not only within the region, but insofar as possible, at the macro level. The project must also promote sustainable practices that would not damage assets or resources that are fundamental for the development of the region. This point is essential in the fight against hunger and in environment-related goals.

A particularly favorable point is quality education. This positively correlates to income, improved health, promoting gender equality, and lessening social inequality. The development of infrastructure is another factor that covers multiple goals. A construction project may attract direct foreign investment, create well-paid jobs, reactivate adjacent industries, integrate markets, and provide basic services like clean water, sanitation, health and electricity. With the help of research and innovation, these services can be environmentally sustainable, more accessible and cheaper. In this regard, it's important that the local institutions ensure, insofar as possible, free and open competition.

All these factors can contribute to building solid institutions that would subsequently aid in the implementation of new projects with improved economies of scale which offer permanent or longer-term solutions. However, HR Ratings recognizes that these points, although universal, do not necessarily cover the specific problems that a region may face. This is addressed in the next section.

Additional goals and assignment of the Stage One rating

HR Ratings recognizes that different projects may offer very specific solutions to different local problems that are not necessarily detailed in the United Nations 2030 Agenda. These will be analyzed in the same way as the other goals, evaluating the project through quantitative metrics whenever possible.

This analysis compares the project in question to other Social Bond projects in terms of its relative contribution to social wellbeing and development, without ignoring the context of the project and its secondary effects. Therefore, to make a clear distinction between the projects assessed, HR Ratings will weight each of the factors mentioned in this section and will place the project in a three-level scale, as follows:

HR SB 1: Bonds or frameworks associated with projects that, considering their nature and context, offer a superior social solution which allows for permanent wellbeing and development, and generates favorable incentives and collateral effects.

¹⁰ HR Ratings jointly publishes the update for the Green Bonds Evaluation Criteria. For more information, visit: <https://www.hrratings.com/es/index>

HR SB 2: Bonds or frameworks associated with projects that, considering their nature and context, offer a good social solution which allows for long term wellbeing and development, and generates adequate incentives with no adverse collateral effects

HR SB 3: Bonds associated with projects that, considering their nature and context, offer an acceptable social solution which allows for certain wellbeing and development, does not alter incentives, and has limited adverse collateral effects.

Stage Two: Compliance with the Social Bond Principles¹¹

On the completion of Stage One and with the bonds or frameworks classified as described, HR Ratings will then proceed to stage two of the analysis. This consists of differentiating the bonds according to the level of compliance, by the issuer, with each of the following principles: 1) the use of resources, 2) the process for project evaluation and selection, 3) the management of the resources, and 4) reporting. The level of compliance is presented according to a three-level scale, which is included in the final Social Level.

1) Use of resources

The issuer must clearly describe in the legal documentation for the bond, the project or projects in which the resources received from the placement will be invested. This must include a statement on the social goals of the bond, detailing the project or projects and, where possible, the method or mechanism by which the social benefits are estimated or calculated.

The use of the resources may include refinancing of debt contracted to finance these projects. When a portion or all the funds are used or may be used for refinancing, the issuer must disclose these amounts and the portfolio of projects eligible for refinancing and provide a detailed description of these. HR Ratings will assess the use of the resources based on the following:

- i) Transparency with which the issuer presents the investment plan, including a statement on the social goals of the bond.
- ii) Effectiveness of the investment in terms of a timeline.

2) Process for project evaluation and selection

The issuer must clearly establish and document the mechanism, protocol and/or process for determining the eligibility criteria and the decision-making to know to which project or projects the resources will be assigned.

This will include an explanation of the project's social goals, how it fits with any of the categories established in the 2030 Agenda, and the criteria used to select the project, including where applicable, factors for exclusion, standards, certifications or any other process to identify the collateral risks associated with the project. The project evaluation and selection will be analyzed based on the following:

- i) The level of transparency and the efficiency with which the issuer documents, maintains and applies the decision-making process to determine the eligibility of the project.

¹¹ Some of the concepts used in this section are based on the SBP developed by the International Capital Market Association (ICMA), and also the SDG developed by the United Nations, with additional specific criteria developed by HR Ratings.

- ii) The experience or past performance of the issuer in social bond sectors, or when the issuer's experience is limited, the presence of outside consultants with experience in the field.

3) Management of the resources

The criteria for the management of the resources assesses the capacity, transparency and efficiency of the process to assign the proceeds from the placement of the bond. Naturally, this management process must be fully documented. The elements taken into consideration are:

- i) The implementation of a clear process to keep the market informed as to the management of the resources according to the investment plan for the project, and the management of funds that are in the process of being assigned to the project.
- ii) Transparency in the accounts, subaccounts, trusts or any other management facility in which the proceeds from the offering are placed.
- iii) Verify whether the short-term investments are placed in:
 - a. Short-term cash investment instruments or cash-equivalent instruments under a treasury function;
 - b. Short-term investment instruments that do not include projects that could have a negative impact on society and/or climate change;
 - c. Short-term operations that would reduce the revolving debt before being allocated to the investments for the projects and assets selected.

4) Reporting

Issuers will be required to provide technical information for the project, together with information on the expected social implications, and the amount of resources assigned and their use. Similarly, they must be able to maintain this information updated until the resources have been assigned in full.¹² The assessment of this point will be based on the following:

- i) The quality of the information provided according to qualitative indicators and, insofar as possible, quantitative indicators (for example, number of people benefited in terms of poverty measures or access to services, estimates of benefits from savings in resources or increased consumption, etc.).
- ii) The frequency with which the issuer offers this information.
- iii) Independent audits of the information provided.

Considering the criteria mentioned in each of the SBP, HR Ratings will assign an indicator for the level of compliance for each of the four principles. As mentioned, this assessment is based on qualitative elements. The overall evaluation will inform the market, based on a three-level scale, as to the efficiency and transparency of the assignment and management of the resources, the decision-making for eligible projects, and the quality with which the issuer reports on the project.

Each of the considerations associated with the SBP mentioned in the previous section will be assessed according to the following scale: i) Very good, ii) Good, and iii) Sufficient. After

¹² If the proposed project also has an environmental benefit, the issuer will determine and detail the classification of the use of the resources.

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assigning one of the three classifications to each of the four SBP, HR Ratings will then assign the final Social Bond level, considering the number of principles assessed as Very good, Good or Sufficient for the bond.

Table 3, shown below, includes the entire range of possible scenarios. For example, if the issuer has three of the principles identified as Very Good and one as Sufficient, the Social Bond will be rated as Very Good in terms of compliance with the SBP. Meanwhile, if the bond has three as Sufficient and one as Very Good, the classification will be Sufficient. There are four combinations that give a classification of Very Good or Sufficient, and seven that give a classification of Good.

Very good	Good	Sufficient	
4	0	0	Very good
3	1	0	Very good
3	0	1	Very good
2	2	0	Very good
2	1	1	Good
2	0	2	Good
1	3	0	Good
1	2	1	Good
1	1	2	Good
0	4	0	Good
0	3	1	Good
1	0	3	Sufficient
0	2	2	Sufficient
0	1	3	Sufficient
0	0	4	Sufficient

Source: HR Ratings

To identify the classification assigned to a Social Bond the SBEC will use a notation, which will show a “+” sign for Very Good, no sign for Good and a “-” sign for Sufficient.

Assignment of a Social Level

The scale assigned in stage two of the criteria is added to the scale assigned in stage one. This means the final Social Level will inform the market as to how the project is contributing to the fulfillment of the 2030 Agenda, taking into consideration the context and possible secondary effects, and the capacity of the issuer to satisfy the four SBP. The final notation for the Social Level, covering both criteria, is presented in the following table:

Table 4. Final Scale

Identification of the Institution and product	Stage 1: Social Analysis	Stage 2: SBP Compliance	Final Scale
HR SB	1	"+"	HR SB 1+
		"flat"	HR SB 1
		"-"	HR SB 1-
	2	"+"	HR SB 2+
		"flat"	HR SB 2
		"-"	HR SB 2-
	3	"+"	HR SB 3+
		"flat"	HR SB 3
		"-"	HR SB 3-

Source: HR Ratings

Appendix I: Glossary

Social Bonds (SB). In accordance with these criteria, any type of fixed rate asset OR Financial Instrument from which the proceeds are used to finance or refinance, in whole or in part, new or existing social projects.

Social Bonds Evaluation Criteria (SBEC) The criteria developed by HR Ratings that outlines the process for the assessment of Social Bonds and the assignment of a Social Rating.

Social Bond Principles (SBP). Refers to the internationally recognized criteria that set the transparency and policies for information to contribute to the development of the Social Bonds market.

United Nations Development Group (UNDG). Network of 165 countries that brings together 32 funds, programs, specialized agencies and other bodies working in areas of sustainable development.

United Nations Development Program (UNDP). Core part of the United Nations Development Group, present in 170 countries and territories. The UNDP helps countries to develop and share solutions to the challenges associated with three principal areas: i) sustainable development; ii) democratic governance and peacekeeping, and iii) climate and disaster resilience.

Sustainable Development Goals (SDG) and/or Global Goals. Composed of 17 goals with the purpose of adopting measures to end poverty, protect the planet and ensure that all people enjoy peace and prosperity.

Appendix II: Types of bonds

In keeping with the Social Bonds Principles, some of the types of financial instruments that are eligible for assessment, are shown next:

- **Standard Social Bond.** A recourse-to-the-issuer debt obligation where the proceeds are deposited into a subaccount, transferred to a sub-portfolio, or otherwise tracked by the issuer, and certified through a formal internal process that will be linked to the investment operations and issuer loan for eligible projects and assets.
- **Social Revenue Bond.** A non-recourse-to-the-issuer debt obligation where the credit exposure in the bond is to the pledged cash flows of a certain revenue, fees, taxes, etc. The proceeds are deposited into a subaccount, transferred to a protected structure sub-portfolio (ring-fenced, for example, a trust), or otherwise tracked by the issuer, and certified through a formal internal process that will be linked to the investment operations and issuer loan for eligible projects and assets.
- **Social Project Bond.** A bond issued for a single or multiple eligible projects or assets for which the investor has direct exposure to the risk of the project(s) with or without potential recourse to the issuer.
- **Social Securitized Bond.** A bond secured by one or more specific eligible projects and/or assets, including but not limited to asset backed securities (ABS), mortgage backed securities (MBS) and other structures. The first source of payment is generally the cash flows from the assets and/or projects.



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