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Second Party Opinion

Jinan Lixia Holding Group Co. Ltd. Sustainable Finance Framework

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Location: China	**Sector:** Engineering and Construction

Alignment With Principles

Aligned = ✓ Conceptually aligned = O Not aligned = ✕

✓ Social Bond Principles, ICMA, 2023 (with June 2022 Appendix 1)

✓ Social Loan Principles, LMA/LSTA/APLMA, 2023

See Alignment Assessment for more detail.

Strengths

Jinan Lixia Holding Group Co. Ltd. (Jinan Lixia) is a key enabler of Jinan city's policies. In particular, the company supports the local government's mandate to develop affordable housing.

Weaknesses

No weakness to report.

Areas to watch

Jinan Lixia's disclosures are limited. It is unclear how the company manages social and environmental considerations beyond eligible projects under this framework. This is common for Chinese local government-owned entities.

The price and financing terms of affordable housing units will be project specific and the extent of discount is unknown. Jinan Lixia, however, will follow the local government's guidance on setting prices and commits to keep the rental cost below 90% of the market price.

Convertible bonds could be issued under the framework. They potentially pose a challenge for allocation reporting if the period of allocation extends past conversion. However, because of the 24-month allocation period, this challenge may not materialize if conversion occurs after the second year. In addition, Jinan Lixia does not expect to issue convertible bonds in the foreseeable future, given that the company is not listed.

Issuer Sustainability Context

This section provides an analysis of the issuer's sustainability management and the embeddedness of the financing framework within its overall strategy.

Company Description

Jinan Lixia is a Chinese local government-owned financing vehicle established in 2016 and based in the Lixia district of Jinan city. It engages in commercial real-estate development (65% of its revenue amounting to Chinese renminbi [RMB] 4.42 billion in 2023), municipal services (e.g., municipal engineering projects and landscaping; 16%), land consolidation (10%), and the remaining comes from asset operation, bio-health, real estate, business management, technology finance, and others.

The Lixia District Finance Bureau of the Lixia District Government owns 90% of Jinan Lixia; and the Shandong Caixin Asset Management Co. Ltd., a wholly owned subsidiary of the Shandong Province Finance Bureau, holds the remaining 10%.

Material Sustainability Factors

Workforce health and safety

Construction sites can expose workers to heightened safety risks from use of heavy machinery, falls from height, hazardous chemicals, and other potentially dangerous situations. These may translate into fatality and injury rates that are high relative to other sectors. The reliance on temporary employees and subcontractors also poses risks because safety protocols for such employees could be lax. Larger companies are typically less affected because of more comprehensive and systematic training, policies, and standards. China has ratified six occupational safety and health international labor conventions. According to the International Labor Organization, the country has made progress over the past two decades, with total workplace fatalities declining by 83% between 2005 and 2021.

Working conditions

Working conditions is one of the most material factors in engineering and construction, particularly from the stakeholder perspective. The population of less-skilled workers in the industry is among the largest globally and is highly vulnerable to labor and human rights issues, especially for temporary and migrant workers. In recent years, the construction industry and its labor recruitment practices have come under increasing scrutiny for conditions of forced labor. Furthermore, many materials commonly used in the sector (notably bricks, cement, and timber) are at the highest risk of being produced in regions using forced labor. In China, the level of national compliance with labor rights was 8.9 out of 10 in 2022, according to the International Labor Organization.

Access and affordability

Low housing stock and lack of affordable options can severely influence livelihoods, especially for the vulnerable, low-income population, leaving them to face the threat of homelessness. Access and affordability are especially important for tenants, for whom rent can account for a large portion of income. Lack of accessibility and affordability of commercial properties can also hinder the sustainable growth of local communities. In China, average new house prices in 100 major cities amounted to RMB16,244 (US$2,244) per square meter in January 2024 as per the China Index Academy, while the country's GDP per capita is US$13,140 in April 2024, according to the International Monetary Fund.

Physical climate risk

Physical climate risk is a material sustainability factor because of the potential damage to assets, and disruptions to many stakeholders and to operations. Acute physical risks--such as typhoons, storms, and floods--can impair, disrupt, or even destroy assets and affect the availability of essential infrastructure. Over time, chronic risks such as an increase in precipitation or rise in sea levels, necessitate designing and building infrastructure that is resilient to known and projected climate hazards. Severe weather events can add risks during the construction phase. Acute and chronic risks could damage properties or place tenant health and safety at risk. They could also require investments to manage potential effects or, in severe cases, relocation of tenants. The likelihood of damage to assets due to extreme weather increases without adaptation, more so in regions exposed to climate hazards. Unabated climate change could lead to GDP losses of 0.5%-2.3% as early as 2030 for China, according to the World Bank. Chinese provinces account for half of the most exposed global regions to extreme weather events by 2050.

Issuer And Context Analysis

The framework's eligible projects are aimed at providing access to affordable housing. As an enabler of government policies, Jinan Lixia plays an important role in promoting the socioeconomic development of Lixia district and Jinan city. Through the development of affordable and resettlement housing (representing 10% of its revenue in 2023 through the land consolidation segment), Jinan Lixia aims to contribute to the country's housing security system, and helps alleviate housing difficulties. The company follows the local government's guidance to set the price and financing terms of these housing units.

Workforce health, safety, and working conditions are important topics in construction. The company has incorporated these considerations into its contractor selection process. For instance, contractors are required to provide safety training and conduct regular safety inspection and monitoring. The company will also rely on feasibility studies to identify and manage potential social risks, which is a standard procedure for development projects in China. Beyond these practices, Jinan Lixia's strategy and commitments in this regard appear limited to abiding by laws and regulations.

Jinan Lixia's disclosures on physical risks are limited. Jinan Lixia relies on third-party feasibility studies and impact assessments to establish systems to manage adverse climate impacts to its operations and assets. The company has limited disclosure on how it addresses physical risks in general, beyond compliance with local regulations, despite appearing common among local government-owned entities in China.

Jinan Lixia is yet to disclose its sustainability performance. This is largely comparable to that for other local government-owned entities in China. Insight is limited on the company's agenda to address these material sustainability factors and how its operations beyond the projects included in this framework may affect its consolidated sustainability performance. Apart from the annual commitment to disclose the expected and actual impact of financed projects, there are no concrete plans or timeline for disclosing more comprehensive information, such as a sustainability report, on its sustainability performance, targets, and initiatives.

Alignment Assessment

This section provides an analysis of the framework's alignment to Social Bond and Loan principles.

Alignment With Principles

Aligned = ✓ Conceptually aligned = O Not aligned = ✕

✓ Social Bond Principles, ICMA, 2023 (with June 2022 Appendix 1)

✓ Social Loan Principles, LMA/LSTA/APLMA, 2023

✓ Use of proceeds

All the framework's social project category is aligned, and Jinan Lixia commits to allocate the net proceeds issued under the framework exclusively to eligible social projects. Please refer to the Analysis of Eligible Projects section for more information on our analysis of the social benefits of the expected use of proceeds. Other forms of debt instruments such as convertible bonds are eligible under the framework. However, Jinan Lixia communicated that it does not expect to issue convertible bonds in the foreseeable future, given that the company is not listed.

The company will disclose the proportion of financing versus refinancing in its allocation reporting. The maximum look-back period for refinanced projects is three years after issuance, in line with market practice.

✓ Process for project evaluation and selection

Jinan Lixia's sustainable work group (SWG) comprises representatives from senior management, planning and design, industry planning, financial management, enterprise management, production planning, legal audit, asset management, human resources, and general management functions. The SWG will meet annually to screen the potential projects based on the framework's eligibility criteria. The identification and management of potential social and environmental risks (e.g., compliance with environmental and social regulations, impacts on local communities, social well-being) related to projects will be part of the projects' feasibility reports. Shortlisted projects will then be presented to the board of directors for approval. The framework includes exclusion criteria that reference the International Finance Corp.'s exclusion list, covering topics such as weapons and munitions, alcoholic beverages, tobacco, and gambling.

✓ Management of proceeds

The net proceeds or an equal amount to the net proceeds will be deposited in the company's funding accounts. Jinan Lixia will maintain a register to track the allocation of proceeds. The company commits to periodically adjusting the tracked net proceeds to match allocations to eligible projects during the time the instrument is outstanding. Pending allocation, unallocated proceeds will be invested in treasury bonds, policy bank financial bonds, local government bonds, and cash deposits.

✓ Reporting

Jinan Lixia commits to report annually on the allocation of the net proceeds and on the financed projects' impact, until full allocation of the net proceeds. The information will be available on the company website or annual report. Allocation reporting will include the aggregate amount allocated, share of financing versus refinancing, brief description of the projects, and target populations. Meanwhile, impact reporting will include the actual and expected impacts of the financed projects. Impact indicators include the number of affordable housing units constructed, number of individuals benefitted, and the rental cost or purchase price compared with the private market.

Convertible bonds potentially pose a challenge for allocation reporting if the period of allocation extends past conversion. However, because of the 24-month allocation period, this challenge may not materialize if conversion occurs after the second year.

Analysis Of Eligible Projects

This section provides details of our analysis of eligible projects considered to have clear social benefits and to address or mitigate a key social issue.

Over the two years following issuance of the financing, Jinan Lixia will allocate all the net proceeds to refinancing affordable housing projects.

Affordable housing

- Expenditures related to construction, maintenance, and upgrading of affordable houses or resettlement housing projects according to government policies.
- The government will decide the price and financing terms and ensure that they will be in line with the market.
- The return from such projects is meager and much lower than the market return.

Analytical considerations

- The construction, maintenance, and upgrade of affordable and resettlement housing helps improve housing conditions for low-income households. It aligns with the housing-security initiative under China's 14th Five-Year Plan and the "Three Major Projects" initiative. Announced in 2023, the "Three Major Projects" initiative focuses on three pillars, which are affordable housing, rural vitalization, and public infrastructure for normal and emergency use (see "China LGFV's Bigger Housing Role: Risk Control Matters," published March 27, 2024).
- The price and financing terms of housing units will be set by the local government. Every housing project will have different price and financing terms, following the government's guidance. Jinan Lixia communicated that the rental cost of housing units will not be higher than 90% of the market price, but the extent of discount is unknown. Meanwhile, residents do not need to pay for resettlement housing.
- The target population is identified by referencing the guidance of the Jinan Municipal Housing and Urban-Rural Development Bureau, adding credibility to the eligibility criteria. Permanent residents of the Jinan city who belong to the classifications of low-middle income group or low-income group will be eligible. Low-middle income refers to having an annual income between 60% to 80% of the local per capita disposable income of the previous year while low-income group refers to having an annual income lower than 60% of that. As of February 2024, the 60% and 80% boundaries of per capita annual disposable income of Jinan city are RMB37,504 (US$5,261) and RMB50,005 (US$7,014), respectively.
- The development of affordable properties or resettlement housing may involve the relocation of existing residents. Jinan Lixia confirms that all demolition and relocation processes comply with relevant laws and regulations, as well as government guidance through signing the commission agreement. The company will systematically use feasibility studies covering the identification and assessment of potential impacts on the community such as displacement, employment opportunities, and social well-being.
- The construction of residential units raises the issue of real estate's climate resilience and climate transition. While the framework does not set out specific performance criteria for the housing units, the feasibility studies will include potential negative environmental impacts. Jinan Lixia also has incorporated some environmental considerations into its contractor selection process for waste management, pollution control, biodiversity, and compliance with relevant regulatory requirements.

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

Where the Financing documentation references the Sustainable Development Goals (SDGs), we consider which SDGs it contributes to. We compare the activities funded by the Financing to the International Capital Markets Association (ICMA) SDG mapping and outline the intended linkages within our SPO analysis. Our assessment of SDG mapping does not impact our alignment opinion.

This framework intends to contribute to the following SDGs:

Use of proceeds	SDGs	
Affordable housing	 ***1. No poverty**	 ***11. Sustainable cities and communities**

*The eligible project categories link to these SDGs in the ICMA mapping.

Related Research

- China LGFVs' Bigger Housing Role: Risk Control Matters, March 27, 2024
- Analytical Approach: Shades of Green Assessments, July 27, 2023
- Analytical Approach: Second Party Opinions: Use of Proceeds, July 27, 2023
- FAQ: Applying Our Integrated Analytical Approach For Use-Of-Proceeds SPOs, July 27, 2023
- ESG Materiality Map: Engineering And Construction, Oct. 6, 2022

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