

## ASSESSMENT

17 December 2024



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# Japan Finance Organization for Municipalities

## Second Party Opinion – Green Bond Framework Updated SQS2 Sustainability Quality Score

### Summary

We have assigned an SQS2 sustainability quality score (very good) to Japan Finance Organization for Municipalities' (JFM) green bond framework dated December 2022. JFM has established its use-of-proceeds framework with the aim of financing a single eligible green project category: sustainable water and wastewater management. The framework is aligned with the four core components of the International Capital Market Association's (ICMA) Green Bond Principles 2021 (including June 2022 Appendix 1) and demonstrates a high contribution to sustainability.

### Sustainability quality score



### Alignment with principles USE OF PROCEEDS

#### Overall alignment



#### FACTORS

#### ALIGNMENT

Use of proceeds	<div></div>
Evaluation and selection	<div></div>
Management of proceeds	<div></div>
Reporting	<div></div>

### Contribution to sustainability

#### Final contribution to sustainability



#### Preliminary contribution to sustainability

Relevance and magnitude

Additional considerations **No adjustment**

POINT-IN-TIME ASSESSMENT

## Scope

We have provided a Second Party Opinion (SPO) on the sustainability credentials of JFM's green bond framework, including the framework's alignment with the ICMA's Green Bond Principles (GBP) 2021 (including June 2022, Appendix 1). Under its framework, the organization plans to issue use-of-proceeds green bonds to finance a single eligible green project category — sustainable water and wastewater management — as outlined in Appendix 3 of this report.

Our assessment is based on the framework dated December 2022, and the draft JFM Green Bond Impact Report 2024, and our opinion reflects our point-in-time assessment<sup>1</sup> of the details contained in this version of the framework, as well as other public and non-public information provided by the agency.

We produced this SPO based on our [Assessment Framework: Second Party Opinions on Sustainable Debt](#), published in November 2024.

## Recent developments

Following finalization of its green bond framework in December 2022, JFM issued its green bond in January 2024. Net proceeds from the EUR 500 million offering have been fully allocated to the sustainable water and wastewater management related projects, which is the single eligible green project category in the organization's framework (Appendix 3).

The organization intends to publish its JFM green bond impact report 2024 in December 2024, which covers all aspects originally anticipated under the organization's framework, including details on the specific projects - the amount of proceeds allocated at lending project level, as well as the sustainable benefits with relevant environmental reporting indicators. The company did not identify any material developments, issues or controversies related to the eligible category, and thus did not report on any of these items in its report.

As highlighted in the organization's impact report, 60% of the proceed was allocated to the installation, renewal, and reconstruction of pipes. The rest of the proceeds were allocated to other sewage related projects such as construction, renewal, and reconstruction of sewerage treatment plant, sludge treatment plant, pump station, as well as advanced treatment plant. The company has fulfilled all the commitments made in the framework and the details of the projects align with the assumptions in our original analysis. We are thus maintaining all assigned scores in this updated SPO.

## Issuer profile

Japan Finance Organization for Municipalities (JFM) is a financial institution dedicated to providing long-term, low-cost funding to Japanese regional and local governments (RLGs). Established in 2008 based on the Japan Finance Organization for Municipalities Act<sup>2</sup>, it is jointly owned by Japanese RLGs.

JFM has increased its lending to cover the RLGs' tax-supported activities since 2009, in addition to increasing its traditional lending to the RLGs' public enterprise funds that manage non-tax-supported, fee-based operations, such as water, sewage and mass transportation.

JFM aims at supporting the sustainability of Japanese local authorities primarily through its lending to address the environmental and social issues faced by local governments, such as sewerage, hospitals, disaster management and mitigation, as well as educational and social welfare facilities development. Sewage-related lending accounts for 27.9%<sup>3</sup> of the total outstanding loans and was the largest category as of the end of March 2024.

## Strengths

- » Financing of sustainable water and wastewater management projects, which is likely to have a high contribution to sustainability
- » Comprehensive and transparent project evaluation and selection process, including robust environmental and social risk mitigation practices
- » Clearly defined and relevant environmental objectives associated with the eligible category
- » Granular reporting, which includes a list of financed projects and detailed impact metrics

- » Short allocation period of no more than 12 months

## Challenges

- » Reporting will only be conducted until full allocation of proceeds
- » There is no commitment to undertake verification or an independent review of the allocation, or impact reporting

## Alignment with principles

JFM's green bond framework is aligned with four core components of the ICMA's Green Bond Principles 2021 (including June 2022 Appendix 1). For a summary alignment with principles scorecard, please see Appendix 1.

- |  |  |
|--|--|
| <input checked="" type="radio"/> Green Bond Principles (GBP)       | <input type="radio"/> Green Loan Principles (GLP)                  |
| <input type="radio"/> Social Bond Principles (SBP)                 | <input type="radio"/> Social Loan Principles (SLP)                 |
| <input type="radio"/> Sustainability-Linked Bond Principles (SLBP) | <input type="radio"/> Sustainability Linked Loan Principles (SLLP) |

## Use of proceeds



### Clarity of the eligible categories – BEST PRACTICES

JFM has clearly and comprehensively communicated the nature of the spending, the eligibility and exclusion criteria for the financed projects, and the anticipated location of the projects. The eligibility criteria is clearly defined, the organization plans to extend loans to municipalities to finance the sewage-related assets that comply with Japanese laws<sup>4</sup>, which set the detailed standards and requirements of sewage systems in Japan.

### Clarity of the environmental or social objectives – BEST PRACTICES

JFM has clearly outlined the environmental objectives associated with the eligible category, which are considered to be relevant and coherent. These objectives include conservation of water resources and reduction of greenhouse gas emissions. The organization also referenced the UN Sustainable Development Goals (SDGs) as shown in Appendix 2 in articulating the objectives of the eligible category, and the objectives are coherent with the SDGs.

### Clarity of expected benefits – ALIGNED

JFM has identified clear, relevant and measurable expected environmental benefits, which include pollution prevention and control, water resource conservation, recycling of sewage sludge and use of sewage sludge as an energy source. The organization plans to report on these quantitative benefits in its ongoing reporting.

The organization does not disclose the expected share of refinancing in its framework; however, it states that the lookback period is 36 months and the organization commits to report on the share of refinancing in its impact report.

## Process for project evaluation and selection



### Transparency and clarity of the process for defining and monitoring eligible projects – ALIGNED

JFM has established a clear process for determining the eligibility of projects and disclosed the details in its public framework. In addition to following the standard loan screening procedure, which includes the loan department confirming that the borrower has fulfilled the requirements of Japanese laws related to the sewage projects, the Sustainability Working Group<sup>5</sup> will be responsible for evaluating and selecting the projects to be financed by any specific green bond. In evaluating and selecting the projects, the working group will conduct surveys to understand the impact. The roles and responsibilities for project evaluation and selection are clearly disclosed and include relevant expertise. The monitoring of continued compliance will be done through an on-site inspection until full allocation of the proceeds, which will occur in the following fiscal years. The process for evaluation, selection and monitoring is documented and internally traceable. The inclusion of the environmental and social risk mitigating process is required by Japanese sewage-related laws, and JFM will only extend loans to projects that fulfill this requirement and receive consent or approval from the

relevant authorities. Furthermore, JFM conducts surveys to ensure that the loans are exclusively used for the stated projects, and can request a full repayment if the results are unsatisfactory.

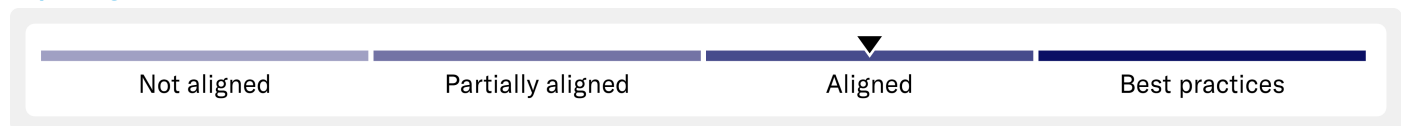
### Management of proceeds



#### Allocation and tracking of proceeds – BEST PRACTICES

JFM has defined a clear allocation and tracking process, which is disclosed in the framework. Net proceeds from any bonds issued under the framework will be placed in JFM's general treasury account and will be separately tracked under a formalized internal process to ensure that the proceeds are used for eligible projects only. The working group will ensure that the balance of the net proceeds will match allocations to eligible projects by extending loans that have longer maturities than the green bonds. In case the loans are redeemed, the organization commits to replace such projects. The proceeds will be allocated within 12 months, and the temporarily unallocated proceeds will be invested in JFM's liquidity portfolio as cash and cash equivalents.

### Reporting



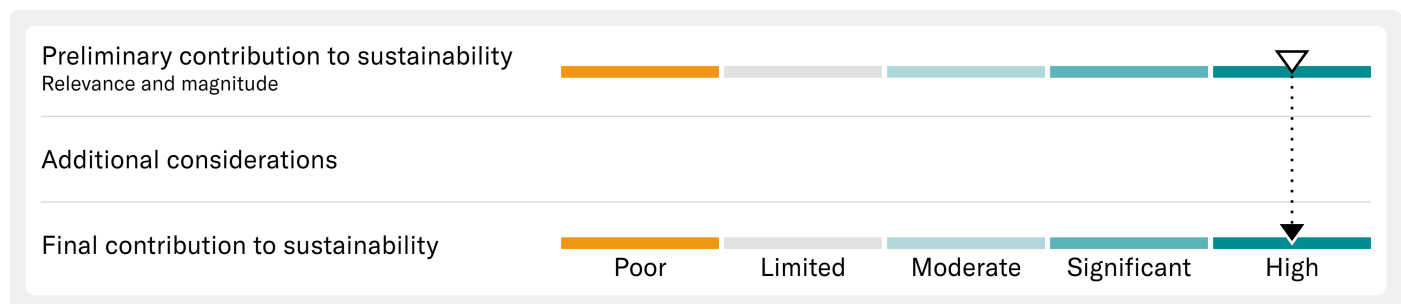
#### Reporting transparency – ALIGNED

JFM will report annually on the allocation and impact of the bonds issued under its framework, and this reporting will be made publicly available on the organization's website. Reporting will occur until the full allocation of the funds and in the event of significant developments.

The reporting will be exhaustive, covering the amount of net proceeds, breakdown of projects, environmental reporting indicators that are clear and relevant such as water management capacity, and case studies. The methodologies and assumptions used to report on the environmental impacts will follow the relevant standards and guidelines stipulated by the Japanese sewage-related laws.

### Contribution to sustainability

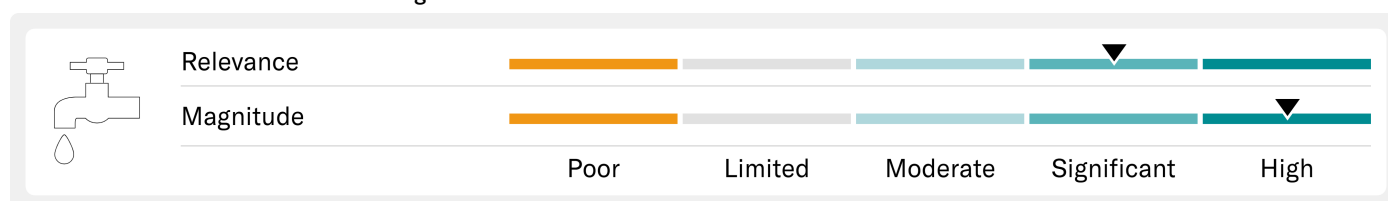
The framework demonstrates a high overall contribution to sustainability. This reflects a preliminary contribution to sustainability score of high, based on the relevance and magnitude of the eligible project categories, and we have not made an adjustment to the preliminary score based on additional contribution to sustainability considerations.



#### Preliminary contribution to sustainability

The preliminary contribution to sustainability is high, based on the relevance and magnitude of the eligible project categories. A detailed assessment by eligible category has been provided below.

## Sustainable water and wastewater management



The project exhibits significant relevance overall. The continued investments in sewage-related assets are very important to Japan's efforts to manage wastewater, especially because the country is prone to natural disasters. Typhoons and extreme rains could overwhelm the sewage systems and earthquakes could damage them, and therefore, the facilities need to be maintained well to minimize the impact of such natural disasters. In addition, the facilities need to be renewed or upgraded, or both, because these were mostly constructed in 1960-80. Furthermore, sewage treatment is an energy-intensive process, accounting for 35%<sup>6</sup> of total greenhouse gas (GHG) emissions by the Metropolitan Government of Tokyo in 2020, for example. Therefore, use of sewage sludge as an energy source and recycling of sewage sludge are crucial to reducing GHG emissions. On the other hand, the sewage system in Japan is already well-established, with a penetration of 93.3% as of the end of March 2024<sup>7</sup>.

The magnitude of category is high. The eligible projects are expected to generate positive long-term environmental impact by preventing water pollution in Japan. The water pollution is likely to be effectively minimized, as funded sewage projects will follow strict standards on water quality, which were stipulated following several water quality issues Japan faced during the 1950s-70s. While there is no thresholds set on energy consumption of the plants, the eligible projects will rely on established and proven technology to improve the energy efficiency from treatment process, for example by replacing the gas-based stirring system for digested sludge with an energy efficient mechanical system. In addition, the wastewater treatment also includes gas capture from its sewage sludge treatment process and use it as energy source, which is broadly in line with technical screening criteria of EU Taxonomy.

#### Additional contribution to sustainability considerations

We have not made an adjustment to the preliminary contribution to sustainability score based on additional considerations.

JFM has a robust due diligence process in place to manage the E&S risks associated with the projects. The sewage-related activities are regulated by Japan's sewage-related laws, and JFM will review necessary consent/approvals to prevent and minimize the relevant negative externalities. The breach of sewage laws, including those related to water quality standards, could lead to legal actions.

The project to be financed under JFM's framework aligns with its broader sustainability priorities because sewage-related lending was the largest loan category as of the end of March 2024.

## Appendix 1 - Alignment with principles scorecard for JFM's green bond framework

Factor	Sub-factor	Component	Component score	Sub-factor score	Factor score
Use of proceeds	Clarity of the eligible categories	Nature of expenditure	A	Best practices	Aligned
		Definition of content, eligibility and exclusion criteria for nearly all categories	A		
		Location	A		
		BP: Definition of content, eligibility and exclusion criteria for all categories	Yes		
	Clarity of the objectives	Relevance of objectives to project categories for nearly all categories	A	Best practices	
		Coherence of project category objectives with standards for nearly all categories	A		
		BP: Objectives are defined, relevant and coherent for all categories	Yes		
	Clarity of expected benefits	Identification and relevance of expected benefits for nearly all categories	A	Aligned	
		Measurability of expected benefits for nearly all categories	A		
		BP: Relevant benefits are identified for all categories	Yes		
		BP: Benefits are measurable for all categories	Yes		
		BP: Disclosure of refinancing prior to issuance and in post-allocation reporting	No		
		BP: Commitment to communicate refinancing look-back period prior to issuance	Yes		
Process for project evaluation and selection	Transparency and clarity of the process for defining and monitoring eligible projects	Clarity of the process	A	Aligned	Aligned
		Disclosure of the process	A		
		Transparency of the environmental and social risk mitigation process	A		
		BP: Monitoring of continued project compliance	No		
Management of proceeds	Allocation and tracking of proceeds	Tracking of proceeds	A	Best practices	Best practices
		Periodic adjustment of proceeds to match allocations	A		
		Disclosure of the intended types of temporary placements of unallocated proceeds	A		
		BP: Disclosure of the proceeds management process	Yes		
		BP: Allocation period is 24 months or less	Yes		
Reporting	Reporting transparency	Reporting frequency	A	Aligned	Aligned
		Reporting duration	A		
		Report disclosure	A		
		Reporting exhaustivity	A		
		BP: Allocation reporting at least until full allocation of proceeds, and impact reporting until full bond maturity or loan payback	No		
		BP: Clarity and relevance of the indicators on the sustainability benefits	Yes		
		BP: Disclosure of reporting methodology and calculation assumptions	Yes		
		BP: Independent external auditor, or other third party, to verify the tracking and allocation of funds	No		
		BP: Independent impact assessment on environmental and social benefits	No		
Overall alignment with principles score:					Aligned

Legend: BP - Best practice, A - Aligned, PA - Partially aligned, NA - Not aligned

## Appendix 2 - Mapping eligible categories to the United Nations' Sustainable Development Goals

The eligible category included in JFM's framework is likely to contribute to seven of the United Nations' Sustainable Development Goals (SDGs), namely:

UN SDG 17 Goals		SDG Targets
GOAL 3: Good Health and Well-being	<i>Sustainable Water and Wastewater Management</i>	3.9: Substantially reduce the number of deaths and illnesses from hazardous chemicals and air, water and soil pollution
GOAL 6: Clean Water and Sanitation		6.3: Improve water quality by reducing pollution, eliminating dumping and minimizing hazardous chemicals and materials
GOAL 11: Sustainable Cities and Communities		11.5: Reduce deaths, people affected and economic losses caused by disasters, particularly for people in vulnerable situations
GOAL 12: Responsible Consumption and Production		12.5: Substantially reduce waste generation through prevention, reduction, recycling and reuse
GOAL 13: Climate Action		13.1: Strengthen resilience and adaptive capacity to climate-related hazards and natural disasters in all countries
GOAL 14: Life Below Water		14.1: Prevent and significantly reduce marine pollution of all kinds, in particular from land-based activities
GOAL 15: Life on Land		15.1: Ensure the conservation and sustainable use of terrestrial and inland freshwater ecosystems and their services

The United Nations' Sustainable Development Goals (SDGs) mapping in this SPO considers the eligible project categories and associated sustainability objectives/benefits documented in the issuer's financing framework, as well as resources and guidelines from public institutions, such as the ICMA SDG Mapping Guidance and the UN SDG targets and indicators.



### Appendix 3 - Summary of eligible categories in JFM's framework and projects financed with proceeds from January 2024 Green Bond

Eligible Category	Description	Sustainable Objectives	Proceeds Allocation (Jan 2024 Green Bond)	Impact Reporting Metrics	Reported Impact
Sustainable water and wastewater management	Development, construction, maintenance, updates, operation of sewerage related assets, which comply with sewage drainage standards set by Japanese law including: - Sewerage Management-Related Facilities - Facility/Equipment - Pipes	Pollution Prevention and Control  Water Resource Conservation  Energy use of sewage sludge, sewage sludge recycle	EUR 500 million	- Population of the covered area - Water management capacity and water quality impact (where relevant) - Absolute amount of sludge treated and disposed of (where relevant) - Newly constructed pipe length and/or total pipe length (where relevant) - Other positive environmental impacts	- Total population of treated area: 21,314,872 - Amount of electricity saved: 18,108,765 kWh - Total extension of pipes: 603.5 km - The volume of treated water: 3,316,519,888 m3

### Endnotes

<sup>1</sup> Point-in-time assessment is applicable only on date of assignment or update.

<sup>2</sup> [The Japan Finance Organization for Municipalities Act](#)

<sup>3</sup> [Annual Report 2024.](#)

<sup>4</sup> The laws are the Sewage Act, the Water Pollution Prevention Act and the Purification Tank Act.

<sup>5</sup> The working group was renamed from the "Green Bond Working Group".

<sup>6</sup> [Committee on reducing the GHG emissions from sewage system by half.](#)

<sup>7</sup> [The sewage system penetration as of the end of March 2024](#), accessed on November 2024

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