

THE ROLE OF LEASING IN ENABLING THE TRANSITION TO A CLIMATE-NEUTRAL AND SUSTAINABLE EUROPEAN ECONOMY

Implications for banking and financial services
sustainability reporting

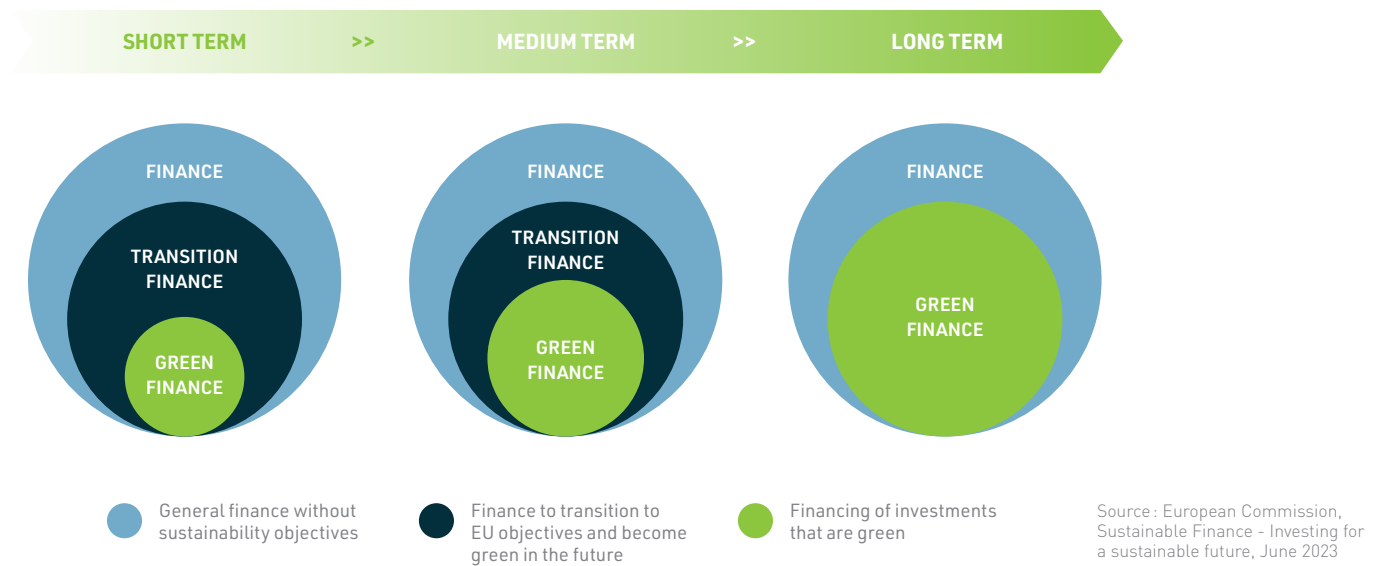
MARCH 2024



IN THE SHORT TO MEDIUM-TERM, TRANSITION FINANCE IS EXPECTED TO BE FAR MORE SIGNIFICANT THAN GREEN FINANCE

In its publication : *Sustainable Finance - Investing for a sustainable future in June 2023*, The European Commission noted that : 'Sustainable finance is about financing both what is already environmentally friendly (green finance) and the transition to environment-friendly performance levels over time (transition finance)'.

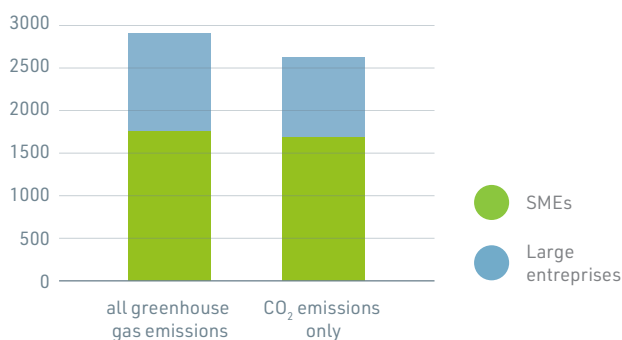
INVESTING IN THE TRANSITION



EUROPE'S SMALL AND MEDIUM-SIZED BUSINESSES HAVE A CRUCIAL ROLE IN ACHIEVING A MORE SUSTAINABLE ECONOMY...

Europe's 30 million small and medium-sized enterprises (SMEs) represent 98% of all businesses in the EU (Source Eurostat). Together, they represent 63% of all business CO₂ and greenhouse gas emission.

EMISSIONS BY EUROPEAN ENTERPRISES IN MILLION TONS, 2018



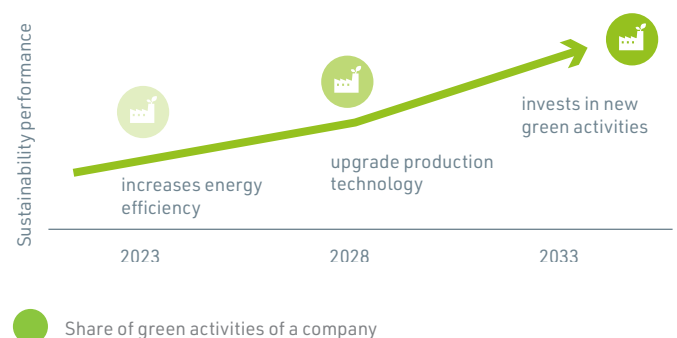
Source: European Commission 2022 - Annual Report on European SMEs 2021/2022: SMEs and environmental sustainability Background document

...BUT MOST SMES ARE AT AN EARLY STAGE OF TRANSITION

SMEs are typically only starting their transition towards low or zero emissions. Compared to larger companies, few are making substantial investments that can easily be classified as green, instead they are choosing options that promote environmental objectives when upgrading existing technology.

TOOLS FOR FINANCING THE TRANSITION

Example of a company in transition

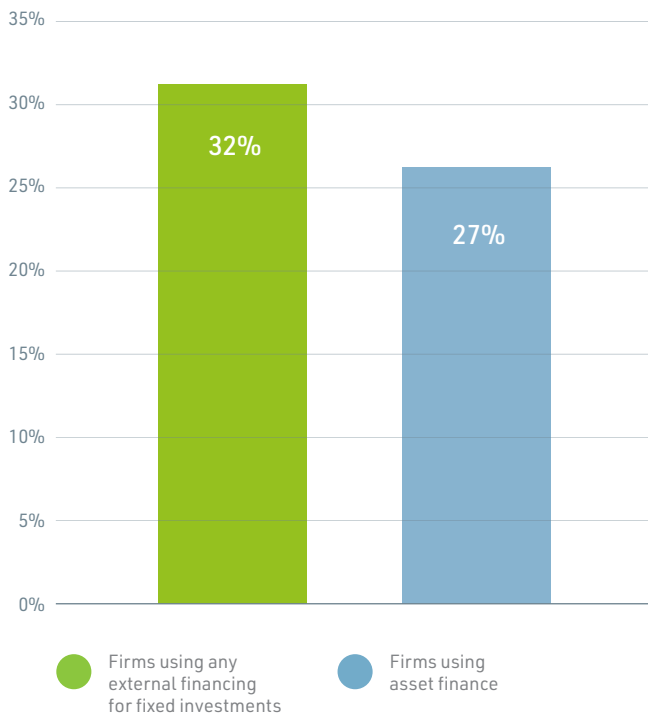


Source : European Commission, Sustainable Finance - Investing for a sustainable future June 2023

SMES THAT MAKE FIXED CAPITAL INVESTMENT MAKE SIGNIFICANT USE OF ASSET FINANCE (LEASING AND HIRE PURCHASE)

As SMEs move to improve their sustainability, they are likely to need external financing and, in particular, asset finance. Because the loan is secured by the asset being financed, it is typically lower cost and easier to obtain than other sources of finance.

SME FIXED INVESTMENT AND USE OF ASSET FINANCE



Source: European Commission and European Central Bank Survey on the Access to Finance of Enterprises (SAFE) Analytical Report 2022 published December 2022

“SMEs need access to different financing instruments to fit their diverse sustainable investment needs. As most SMEs are eco-adopters, i.e. firms seeking to improve the sustainability of their operations, access to debt and other low risk/low return financing (e.g. leasing) is critical to enable these enterprises’ investments in greening.”

Financing SMEs for Sustainability: Drivers, Constraints and Policies, OECD 2022

BOTH FINANCE LEASES AND OPERATING LEASES ARE USED BY SMES TO SUPPORT THEIR SUSTAINABILITY INVESTMENTS

Most longer leases (e.g. 4 years or above) are termed ‘finance leases’ in the national accounting rules used by European SMEs, and shorter leases are termed ‘operating leases’. Finance leases are typically used for manufacturing equipment, and operating leases for vehicles and technology.

Regardless of the accounting treatment all leases play a significant role in supporting SMEs’ sustainability journeys.

Both types of leases involve banks and other leasing companies buying assets and offering use of the assets to the SMEs in return for monthly payments.

In the case of operating leases, the finance provider will efficiently manage the preparation of the returned asset so that it can quickly be used by another SME, or at the end of its useful life responsibly dispose of the asset, maximising the use of recycling. In this way, operating leases are part of the circular economy.

MEASURING AND REPORTING THE ROLE OF LEASING IN ENABLING THE TRANSITION TO A CLIMATE-NEUTRAL AND SUSTAINABLE EUROPEAN ECONOMY

Existing reporting measures based on the European Union Taxonomy for Sustainable Activities, including the Green Asset Ratio, don't capture 'transition finance' and SME finance.

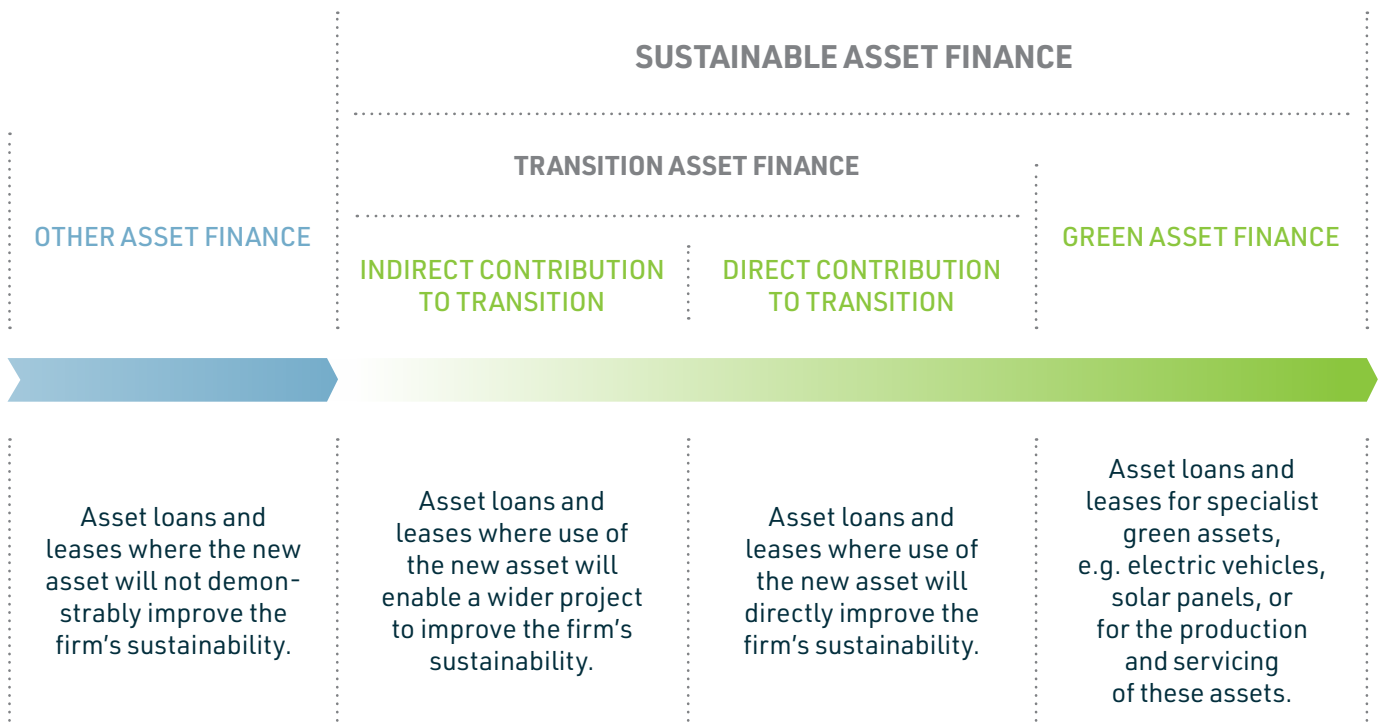
Leaseurope believes that all transition finance, including both finance and operating leases and all finance for SMEs as well as larger companies, should be recognised in reports required from banks and other financial companies.

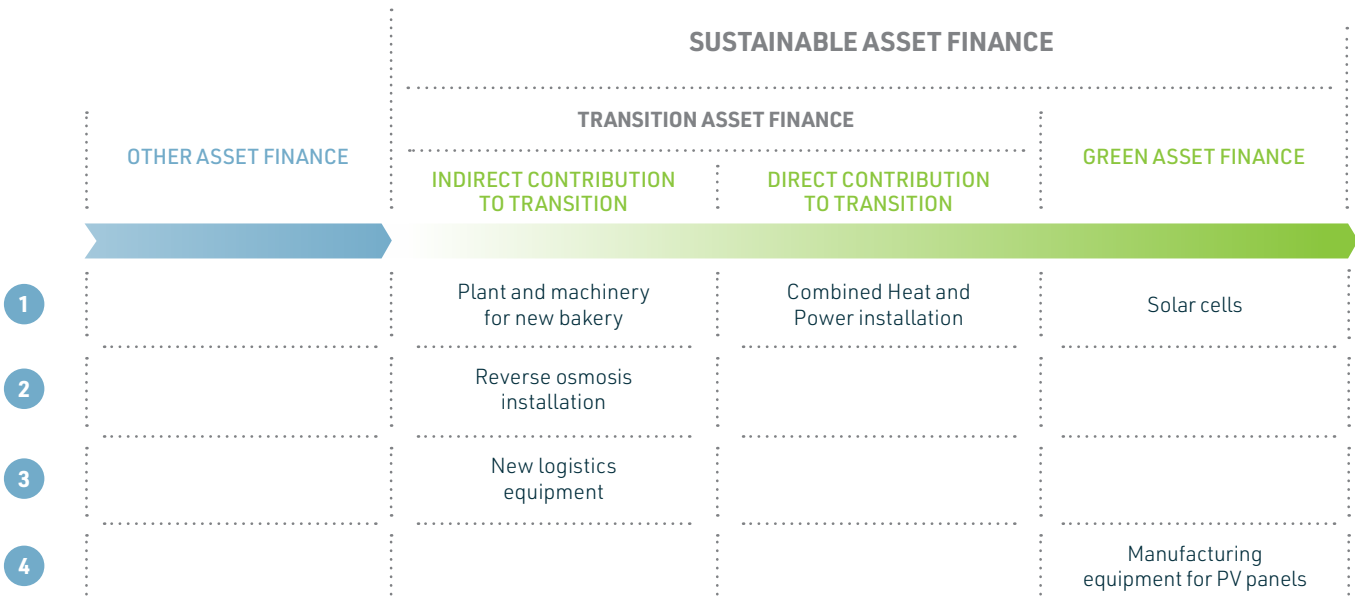
This should include :

- > The EU definition of green loans that is being developed following the recent Opinion of the European Banking Authority
- > Future sector-specific European Sustainability Reporting Standards and the International Financial Reporting Sustainability Standards

These steps are essential to ensure banks and other providers are able to continue to support European SMEs, as well as larger businesses, on their journeys to sustainability.

We set out our high-level proposal for how relevant leases could be categorised in the diagram below. On this basis, and assuming they also meet the 'Do No Significant Harm' to other environmental objectives principle, and adhere to the 'Minimum Social Safeguard' principle outlined in the EU Taxonomy, all leases except those described as 'Other Asset Finance' should be reported as sustainable.





1 NEW BAKERY INCLUDES TRANSITION AND GREEN FINANCE

The traditional bakery, which has a large retail network with patisseries and stand-up cafés, decided to invest in a sustainable future.

With the support of a lessor, the owner-managed bakery is investing in a new bakery, including plant and machinery. With the new building and other projects, the company aims to reduce its CO2 emissions by around 70 per cent.

The building includes sustainability in all areas of production :

- > Solar cells on the roof of the new building
- > A modern combined heat and power plant
- > A bio-reforming plant that utilises leftover baked goods that could no longer be used by customers such as charitable institutions. What would otherwise have been practically worthless is now used as energy to bake new rolls, breads, croissants, or cakes. Remaining residues from this closed fermentation system can also be reused as high-quality natural fertilizer.

2 NEW MANURE PROCESSING EQUIPMENT DELIVERS BOTH COST AND SUSTAINABILITY BENEFITS

This investment is in the processing of manure, specifically the processing of a by-product, by a firm that collects manures from farmers.

The installation was in equipment used for 'reverse osmosis'. It processes incoming liquid manure into a mineral concentrate that can be used as a basis for solid manure products, and a dischargeable thin liquid.

Without this equipment, more production and transportation of fertilisers would be needed, together with more processing of the contaminated liquid outputs. In this way, the reverse osmosis saves fuel, labour and processing, and improves the productivity of the farms.

3 NEW LOGISTICS CENTRE IMPROVES SUPPLY CHAIN EFFICIENCY, REDUCING PACKAGING, WASTAGE AND TRANSPORTATION

Equipment leasing, alongside real estate financing, helped a food manufacturer to invest in a new logistics centre.

The investment consists of a new high-bay warehouse and an automated small parts warehouse, including new systems for packaging and transport order picking.

As well as enabling faster availability and delivery of products, the new logistics centre is part of the sustainability goals set by the family-owned business. It will enable :

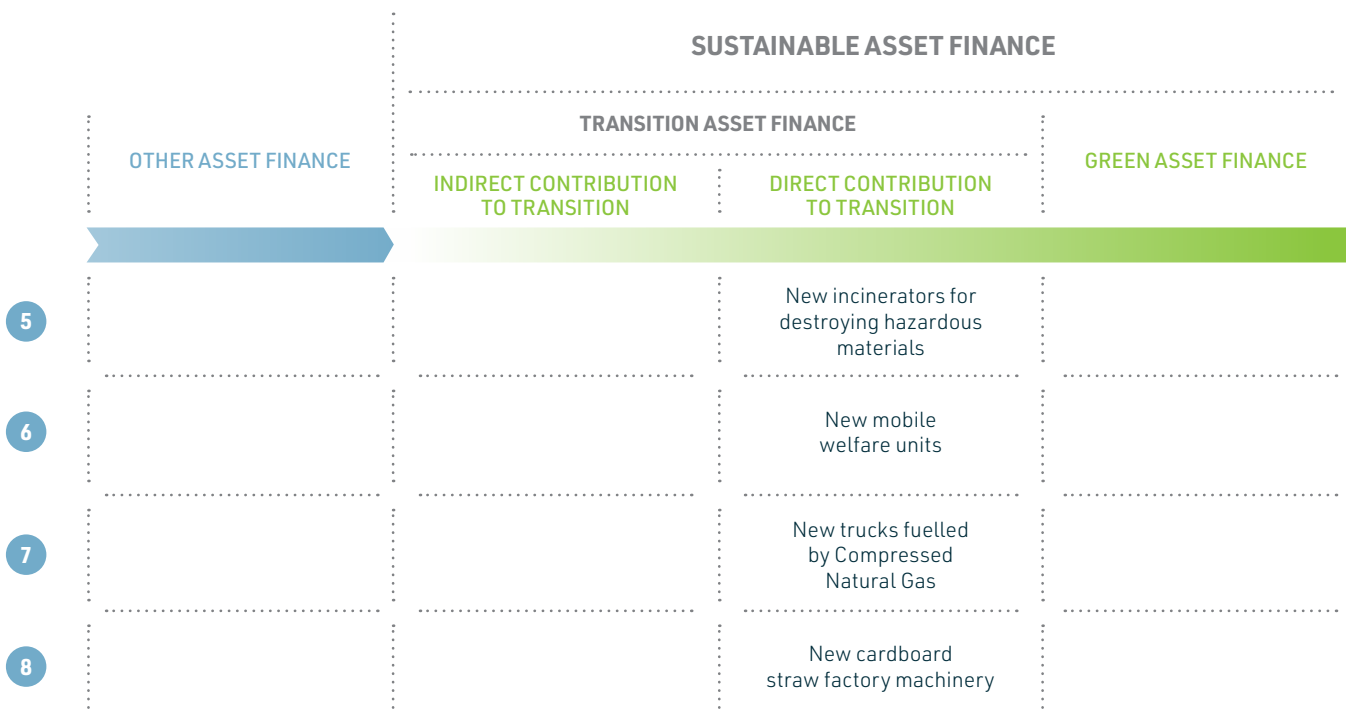
- > More efficient supply chains, with less need for delivery runs to and from the centre
- > Use of more sustainable packaging materials
- > Modern warehouse logistics, e.g. low-emissions plant and low-energy lighting

4 NEW PRODUCTION LINE MACHINES IN FACTORY MAKING PHOTOVOLTAICS PANELS FOR BUILDINGS

A company that develops and produces functional PV façade elements - an innovative option for energy-efficient buildings - required finance for a new production plant.

The investment included leases of specialised machines that were combined with the firm's own automation solutions. The machines handle the glass for the PV modules, and are used in the production process and in inspection and test stations.

As the machines are used in the production of specialist green assets, we consider this to be Green Asset Finance.



5 INCINERATORS FOR GAS ENERGY RECOVERY PROJECT

The operator of a fridge recycling plant needed to invest in new incinerators, that are required to destroy at a high temperature the refrigerant and blowing agent gases from fridges, due to the hazardous materials they contain.

The incinerator also produces heating and hot water from energy recovery, reducing the operator’s carbon emissions.

7 COMPRESSED NATURAL GAS TRUCKS FOR HAULAGE FIRM

A family-owned haulage business specializing in the glass manufacturing industry has set a goal of having a net zero carbon fleet by 2030. As a step towards that goal, it has purchased six trucks fueled by compressed natural gas (CNG).

Whilst CNG is already a lower emissions fuel, the business further demonstrated its commitment to carbon reduction by sourcing Biomethane sourced from anaerobic digestion plants.

6 MOBILE WELFARE UNITS FOR THE CONSTRUCTION INDUSTRY

A hirer of mobile welfare cabins to the construction industry leased 20 new cabins that can be powered by hydrotreated vegetable oil or solar power. The units, that include canteens, toilets and drying rooms, replace previous models powered using diesel fuel.

8 MACHINERY FOR PRODUCTION OF SUSTAINABLE DRINKING STRAWS

This packaging company wanted to find a way of replacing on-pack plastic straws for food and drink cartons with a sustainable paper straw alternative, to help client to meet the European Single-Use Plastics Directive. It decided to invest in new production machinery needed to produce the new straws.

ABOUT LEASEUROPE

Leaseurope, the European Federation of Leasing Company Associations, is an umbrella body bringing together 44 national associations throughout Europe representing bank-owned, captives and independent lessors as well as long and short-term automotive rental companies.

Visit the Leaseurope website at www.leaseurope.org