ta europe
technical advisors

ESG

5 Crucial Facts every Real Estate Manager should know

JULY 2021

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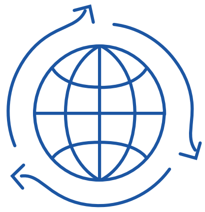
The global climate change has already had observable effects on the environment – with shrinking glaciers, accelerated sea levels and extreme weather phenomena, which seem to have become the 'new normal'. These days, politicians are facing increasing pressure to come up with measures how to mitigate climate change. Unsurprisingly, the real estate industry is also being called into account: By 2030, the building sector is supposed to have reduced its emissions by 55 %, according to the European Green Deal.

Legal initiatives, which have come into effect, might prompt you to take action. We tell you if you are affected – and what you need to do.

And even if you don't have to act right now – we let you know how to anticipate trends – so you are one step ahead when new requirements arise.

1

36%



of greenhouse gas emissions are due to the real estate sector

Presented in 2019, the European Green Deal is a set of policy initiatives by the European Commission with the overarching aim of transforming the **EU** into **the world's first "climate-neutral bloc" by 2050**. This means that **new laws and regulations** will come into effect which are aligned with the major goals. As the real estate industry contributes to 36% of all greenhouse gas emissions – more than any other sector – it is small wonder that policies to reduce emissions are being put in place. It is only a question of time that standards for environmental, social and governance requirements will be established. We expect these standards to become mandatory.

The EU wants to become climate-neutral by 2050. New laws and regulations will come into effect to achieve those goals, prompting real estate managers to rethink and (potentially) redefine their portfolio strategies.

"In the past, investment strategies were made with a focus on the current state of the building and on respective repair and maintenance costs. However, in the future, a purely CAPEX- and OPEX-based evaluation will not suffice", says Dr Annika Neubauer, ESG expert and Associate Director at TA Europe. **"When calculating returns, investors are well-advised to include pro-active measures to raise the building's or portfolio's value with regard to ESG criteria. Especially investments regarding energy saving potentials needs to be considered."**

While the 'bad news' is that there will be more pressure and demand from legal authorities to upgrade buildings accordingly, **new subsidies will become available** as an incentive to those who pursue a truly sustainable strategy, such as the German Federal subsidies for efficient buildings.

2

Financial market participants such as fund managers, asset managers, insurers and banks are required to classify their own financial products as of 10 March 2021 – either as sustainable or non-sustainable. If they state their products to be sustainable, there are two different categories to choose from.

The disclosure regulation came into effect on 10 March 2021. In practice, it establishes **three product categories:** article 6 covers **“normal” funds that do not place explicit emphasis on environmental or ethical aspects.** Article 8 comprises **“light green” funds that take environmental or social criteria into account in the investment process.** Article 9 is reserved for **“dark green” funds that pursue explicit sustainability goals.** Depending on whether a fund falls under article 6, 8 or 9, it must comply with disclosure requirements of varying severity.

As a provider, you need to classify your product by yourself – and have to make it clear in the sales prospectus.

“What has become evident in the past months is that there is a strong interest among our clients to classify their products as sustainable. Some are even afraid that there won’t be any more demand for non-sustainable products in the future. And it is true – more and more people want to invest money in an ESG-compliant way”, explains Kathia Román, ESG and sustainability expert at TA Europe.

However, it should not be forgotten that the disclosure regulation itself reveals very little about the actual quality of a financial product. Contrary to popular belief, it is not like a seal awarded by independent authorities. It is a claim that investors make – and the authorities check only afterwards whether the providers fulfil transparency obligations.

This could change when the second part of the taxonomy regulation comes into effect in January 2022.

3

As of January 2022, the second part of the taxonomy regulation comes into effect. It is supposed to give financial market participants clear definitions on what is sustainable – and to which extent. There will even be a second set of criteria, applicable as of 1 January 2023.

On the 18 June 2020, the European Parliament passed the taxonomy regulation. Designed to make sustainability criteria comparable on an EU-wide level and to prevent 'greenwashing', it is one of the core elements of the EU commission's sustainable finance plan.

This doesn't mean that much as long as the criteria don't have to applied, which will be as of 1 January 2022. The EU's Technical Expert Group (TEG) has developed the following criteria, which are the first part of the overall criteria (the second part is to follow on 1 January 2033):

- New buildings (constructed from 2021): the primary energy demand must be 10 % below the national requirements for a lowest energy building. Air tightness test and, as a rule, thermography for buildings with a usable floor area of more than 5,000 sqm per usable unit. Deviations from planning or deficiencies in this area must be reported to investors and clients. This also applies to the greenhouse potential of the buildings upon request.
- Refurbishment and fundamental renovation: refurbishments must achieve energy savings of at least 30 % or be in line with the national implementation of the EU Buildings Directive, i.e. in Germany the Building Energy Act.

Refurbishments must lead to energy savings of at least

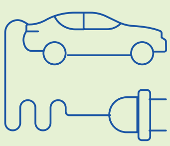
30%

3 Criteria continued

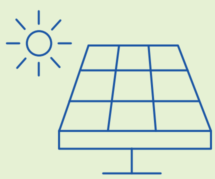
- Specific individual measures: Taxonomy-compliant measures according to the regulation, including photovoltaic systems, wind turbines, improvement of external insulation or charging stations for electric vehicles.
- Acquisition and ownership: buildings constructed by the end of 2020 must have a Class A EPC rating. Otherwise, a property must be in the demonstrably top 15 % of a country or region in terms of primary energy demand. In addition, large non-residential buildings may be subject to testing and documentation requirements for heating, ventilation and air-conditioning systems.

"We have followed the developments on the legal side closely, to be able to provide our clients with an ESG checklist that is always on point and evaluates what is needed to be in line with the first part of the taxonomy requirements", says Dr Annika Neubauer, **"so while we cannot predict the future and don't know which criteria are yet to come, we see tendencies and can give recommendations based on our experience from various projects and from close observations of ongoing political discussions ."**

Sustainability measures, which comply with the taxonomy, include:



Charging stations for electric vehicles



Photovoltaic systems

Better insulation

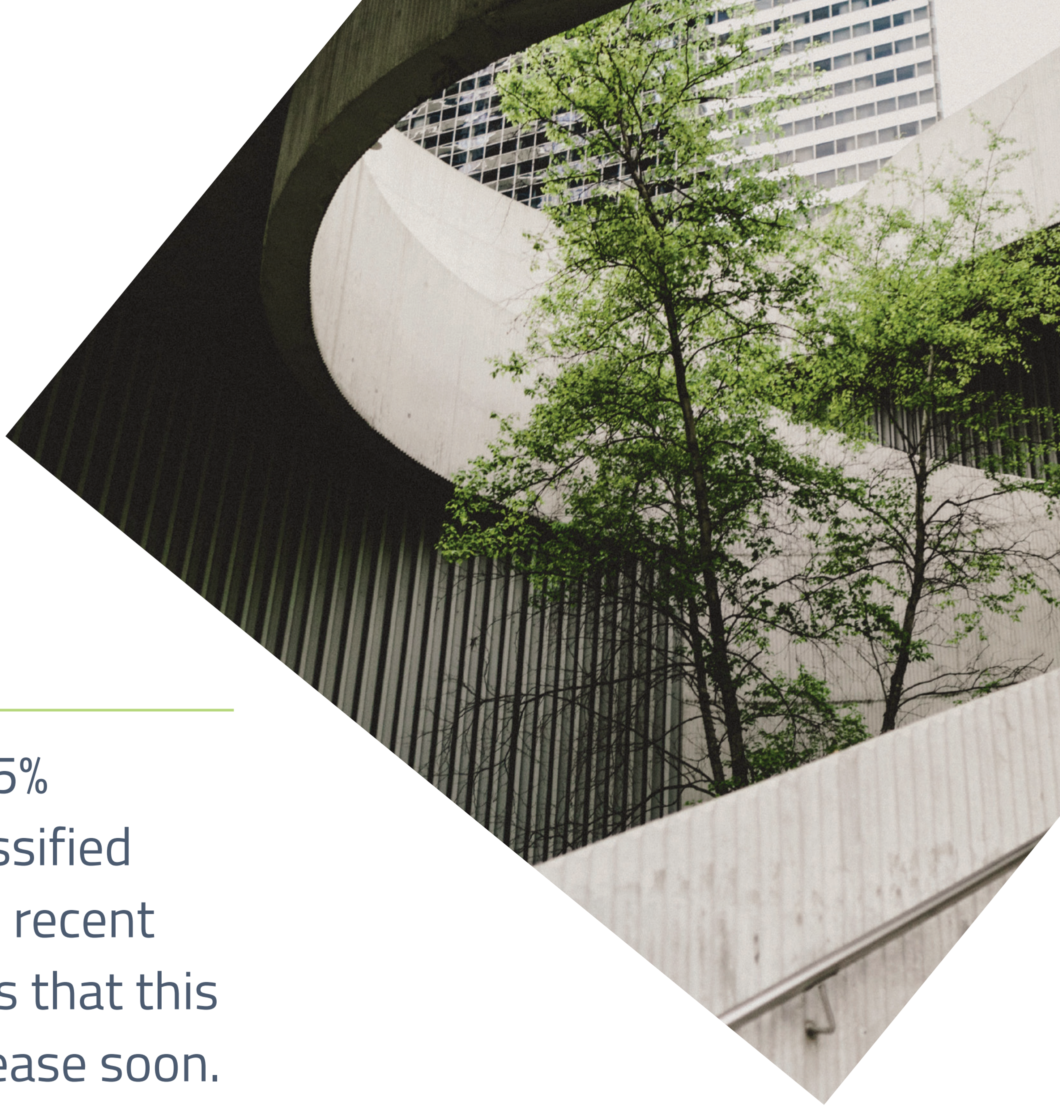
4

Investors who add a substantial environmental due diligence to their due diligence process will have a competitive advantage over those who don't in the long run.

To be able to claim a certain building to be sustainable, many bits and pieces of information need to be collected. This also implies coordination of information from facility management.

"Particularly when it comes to older and more complex buildings, some crucial data might not be available immediately", says Kathia Román, **"So we usually identify the data scope and collection process. Then we let the client know what's missing and take it from there."**

Investors who don't have the necessary information won't be able to classify their assets as sustainable – and might not be able to profit from subsidies, which will very likely be provided to give market participants a chance and reach the ambitious goals as outlined in the EU's Green Deal.



5

Currently, only 25% of assets are classified as sustainable. A recent analysis indicates that this number will increase soon.

The rating agency Morningstar has done thorough research on how many funds classify as sustainable:

The data experts of the research company had evaluated the sales prospectuses of exactly 5,695 open-ended mutual funds and ETFs from Luxembourg as of 29 March. This corresponds to almost half of all special assets from Europe's largest fund domicile.

18 % of these funds were classified according to article 8 ("light green"), another 3.6 % fulfil article 9 ("dark green"). Measured in terms of assets under management, these products represent 25 % of the analysed fund universe. If this ratio is extrapolated to the entire European market, sustainability funds would manage around 2.5 trillion euros.

"For many of the asset managers we spoke to, it is important to have as many funds as possible under articles 8 and 9. They see SFDR [= the Sustainable Financial Disclosure Regulation] as a way to demonstrate their commitment to sustainable investing," comments Hortense Bioy, Global Director of Sustainability Research at Morningstar. In addition, distributors are also trying to influence asset managers, says Bioy. **"They also feel pressured by some distributors and fund buyers who have clearly articulated that they would only consider article 8 and 9 funds in the future."**

The differences between the financial market participants are enormous: While the multi-billion French asset managers Amundi and BNP Paribas have 529 and 310 funds respectively classified under article 8 or 9, the asset management divisions of the major banks UBS and J.P. Morgan currently classify only 54 and 10 funds respectively.

If one compares the volume of funds classified as sustainable to the total assets of the providers that fall under the disclosure regulation, the ratio of Article 8 or Article 9 funds is 60% for Amundi and 80% for BNP Paribas, compared to 11% for UBS and 1.5% for J.P. Morgan Asset Management. However, many providers told Morningstar that they would like to move more funds into the article 8 or 9 category in the coming months.

Your Contacts:



Dr Annika Neubauer
Associate Director

E: Annika.Neubauer@taeurope.com
T: +49 (0)20 54 868 3970

Kathia Román Reina
Project Manager

E: Kathia.Roman@taeurope.com
T: +49 (0)30 243 102 – 622

Jasmin Drescher
Head of Marketing & Communications

E: Jasmin.Drescher@taeurope.com
T: +49 (0)89 69 31 29 30

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