

# Sustainability regulatory update – issue#7

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## EU STRATEGY ON SUSTAINABLE FINANCE *Ongoing - Non-binding initiative*

As part of the [legislative package](#) published by the European Commission (EC) in May 2018, a Technical Expert Group (TEG) has been working over the last months on the technical frameworks of the three main legislative proposals:

- taxonomy,
- benchmarks & green bonds and
- non-financial disclosure to increase transparency of investments.

### TAXONOMY – TECHICAL REPORT

On 18 June, the TEG published its report on the EU Taxonomy along with a call for feedback. EPRA submitted [its position](#). EPRA's main recommendations, also included in the [Taxonomy position paper](#):

### FOCUS ON THE RENOVATIONS OF THE EXISTING BUILDING STOCK

The construction sector continues to grow in Europe. However, the renovation rate remains very slow (averaging around 1% per year) which, as noticed by the TEG, can be due to a number of technical and financial obstacles. To accomplish the climate change targets in the European Union, this is one of the key markets (i.e. the market for major renovation) which needs to be prioritised over the promotion of new constructions. Considering the resources costs of a new construction and the environmental impacts of a new building throughout its entire life cycle, EPRA suggests to not stimulate financing new buildings in a market with high vacancy rates (or vacancy rate beyond the equilibrium), or in a market with negative population growth, as it could lead to providing incentives which in fact negatively impact or mitigate climate change.

### USE OF ACTUAL DATA VERSUS ESTIMATED DATA

With reference to design and in-use performance, listed property companies have noticed a significant gap between the expected and actual performance of a building once in use. We stress that the currently proposed ex-ante approach may lead to capital being allocated to buildings which do not meet the energy or carbon performance they claimed to meet during the design phase. Capital allocation through the use of Energy Performance Certificates (EPCs) is not the ideal tool, as EPCs are not reliable in capturing the real performance of a building, as demonstrated by many studies and acknowledged by the TEG members themselves. In addition, relying only on the ex-ante approach fails to incentivise the collection and then disclosure of the actual performance data of the assets. For those reasons, EPRA proposes in the long term to move from the ex-ante approach, which relies exclusively on data modelling, to an ex-post approach, which reflects the actual performance of the underlying assets.

### ADDRESSING THE LACK OF ACTUAL DATA AVAILABILITY

Ex-ante approach might be considered as a transitional solution which should be strengthened by requiring mandatory monitoring and communication of the actual buildings' performance during their operation so that we can benchmark them against the modelled performance. Afterwards, the Taxonomy methodology should move towards more accurate assessment of the sustainability performance of our buildings. Thereby the Technical Taxonomy would have a tool to feasibly incentivise the ex-post approach alongside the ex-ante approach (as it is the case for Green Bonds). Moreover, the investment community would greatly benefit from such a change as it would increase buildings' data availability in the public domain.

**Official EC documents can be found at the following links:**

- [Technical Report](#) – Building sector is covered from p363 to 386
- [User guide](#)
- [2-page summary](#)

## TAXONOMY – LEGISLATIVE PROPOSAL

The EU Taxonomy regulation proposal is heading towards its formal adoption following a political agreement reached between the EU Council and the European Parliament in December. The taxonomy is set to enable investors to re-orient their investments towards more sustainable businesses and will include (large) listed real estate companies<sup>1</sup> in the scope of the regulation.

EPRA has been strongly advocating over the past months for the inclusion of listed companies in the regulation's scope. More details on EPRA's position can be found at the following [link](#).

### *EPRA's engagement, future actions and timeline*

<b>By Feb 2020</b> TEG to publish the final EU Taxonomy technical report.	EPRA's actions to be decided based on the contents of the final report.
<b>Jun 2019</b> TEG published new reports on <ul style="list-style-type: none"> <li>the EU Taxonomy,</li> <li>an EU Green Bond Standard, and</li> <li>Climate Benchmarks and benchmark's ESG disclosures</li> </ul> TEG launched a call for feedback on Taxonomy.  EC adopted the <a href="#">non-binding guidelines</a> accompanying the NFRD on reporting on climate-related information.	<b>Sept 2019</b> EPRA verified the new recommendations proposed by the TEG and submitted its response to a call for feedback.
<b>Dec 2018</b> EC published a public consultation on the taxonomy proposal.	<b>Dec 2018 to Mar 2019</b> <ul style="list-style-type: none"> <li>EPRA responded to the consultation (<a href="#">link 1</a> and <a href="#">link 2</a>).</li> <li>Follow-up outreach programmes targeting TEG's members to discuss EPRA's position.</li> </ul>
<b>Mid-March 2018</b> EC set an action plan based on the High Level Group's (HLG) outcomes.  <b>May 2018</b> EC adopted a legislative package of proposals on: <ul style="list-style-type: none"> <li>taxonomy,</li> <li>benchmarks including green bonds and</li> <li>non-financial disclosure to increase transparency of investments.</li> </ul>	<b>Sept 2018:</b> <ul style="list-style-type: none"> <li>EPRA revised the three proposals with a particular focus on the EU Taxonomy which has implications for the other two proposals as it defines criteria for classifying economic activities as sustainable.</li> <li>EPRA prepared a position paper that calls for direct investments (listed equities) to be part of the scope of the legislation on Taxonomy.</li> </ul>

<sup>1</sup> With at least 500 employees - the same who are obliged to disclose non-financial information under the Non-financial reporting Directive.

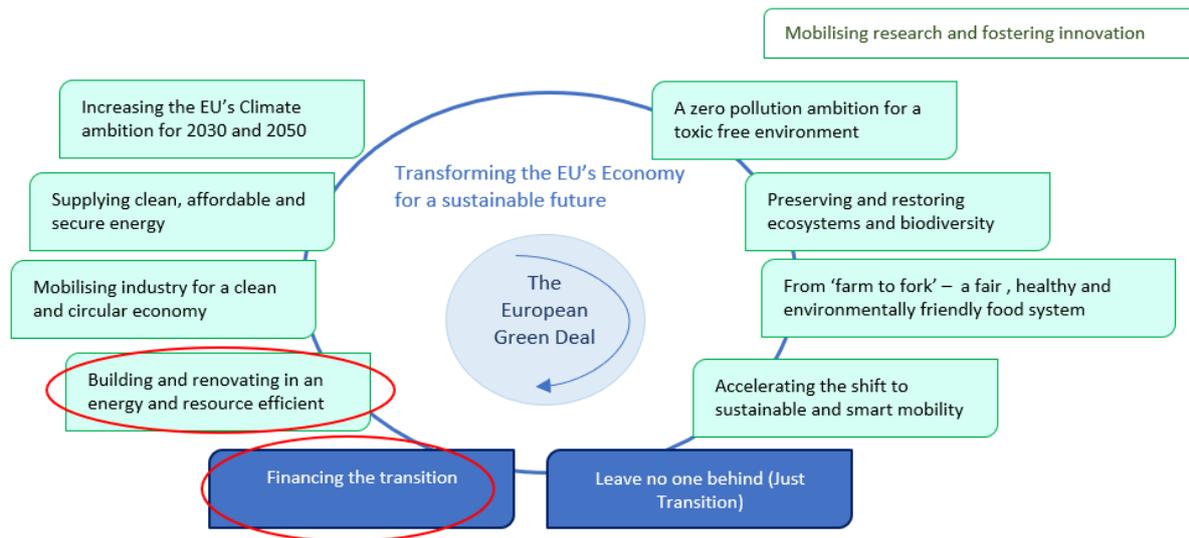
<p>Along with this proposal pack, the EC has also launched four technical groups.</p>	<p><b>Oct-Nov 2018:</b>          EPRA's outreach to the European Council, Parliament and Commission through the technical group on taxonomy composed by PGGM, RICS, CBI and BNP Paribas.</p>
<p><b>End of Jan 2018</b>          HLG published the Final Report on Sustainable Finance with eight recommendations</p>	<p><b>Feb 2018</b>          EPRA identified a set of follow-up actions tailored to the following recommendations:</p> <ul style="list-style-type: none"> <li>• Taxonomy             <ul style="list-style-type: none"> <li>○ A1 - EPRA applied to participate in the Working Committee on sustainable taxonomy</li> </ul> </li> <li>• Non-Financial Reporting Directive update in line with the Task Force on Climate-related Financial Disclosures:             <ul style="list-style-type: none"> <li>○ A1 - Engagement with UNEP FI Property Working Group</li> <li>A2 - Engagement with DG FISMA regarding the Non-Financial Reporting Directive and opportunity to take part to the financial sector-specific technical working group.</li> </ul> </li> </ul>
<p><b>Nov 2017</b>          EC launched a consultation on investors' duties regarding ESG</p>	<p><b>Jan 2018</b>          EPRA responded to the public consultation, available <a href="#">here</a>.</p>
<p><b>Jul 2017</b>          HLG published an <a href="#">interim report</a></p>	<p><b>Jun 2017</b>          EPRA met with Senior Policy Advisor at DG FISMA (Secretariat of the HLG).</p> <p><b>Sept 2017</b>          EPRA responded to the questionnaire promoted by the HLG on Sustainable Finance – interim report which is available <a href="#">here</a>.</p> <p><b>Oct 2017</b>          Together with INREV, EPRA prepared a two-page letter with very specific and pragmatic recommendations to share with the HLG. The document is available <a href="#">here</a>.</p>

## EU GREEN DEAL – *upcoming actions*

The European Green Deal is a new growth strategy that aims to transform the EU into a fair and prosperous society, with a modern, resource-efficient and competitive economy where there are no net emissions of greenhouse gases in 2050 and where economic growth is decoupled from resource use. The new initiative will require efforts to direct private capital towards climate and environmental

action while avoiding lock-in into unsustainable practices. It intends to accelerate and underpin such transition in all sectors. The European Green Deal presents an initial roadmap of the key policies and measures needed to achieve the EU's climate ambitions and will be updated as needs evolve.

The figure below illustrates the various elements of the Green Deal showing the massiveness of the initiative and highlighting the two elements which are most relevant for listed real estate companies.



## MAIN ACTION AREAS RELEVANT FOR LISTED REAL ESTATE

### RENEWED SUSTAINABLE FINANCE STRATEGY

The private sector will be key to financing the green transition. Long-term signals are needed to direct financial and capital flows to green investment and to avoid stranded assets. The Commission will present a renewed sustainable finance strategy in the third quarter of 2020 that will focus on a number of actions. A few of them are listed below as anticipated in the EU Green Deal Communication.

#### 1. EU Taxonomy

First, the strategy will strengthen the foundations for sustainable investment. This will require notably that the European Parliament and Council adopt the taxonomy for classifying environmentally sustainable activities. EPRA can continue on building the relationships with policy makers and other stakeholders and provide them with internal expertise.

#### 2. EU Non-Financial Disclosure

At the same time, companies and financial institutions are expected to increase their disclosure on climate and environmental data so that investors are fully informed about the sustainability of their investments. To this end, the Commission will review the Non-Financial Reporting (NFR) Directive.

Commissioner Valdis Dombrovskis presented in his speech the European Commission's ambition to launch a work on the EU NFR standard and task EFRAG (European Financial Reporting Advisory Group) to initiate the work.

#### 3. EU Corporate Governance Framework

Sustainability should be further embedded into the corporate governance framework, as many companies still focus too much on short-term financial performance compared to their long-term development and sustainability aspects.

#### **4. *Green labels for retail investment products and EU green bond standard***

Second, increased opportunities will be provided for investors and companies by making it easier for them to identify sustainable investments and ensuring that they are credible. This could be done via clear labels for retail investment products and by developing an EU green bond standard that facilitates sustainable investment in the most convenient way.

#### **5. *Adjustment of the EU prudential rules for green assets***

Third, climate and environmental risks will be managed and integrated into the financial system. This means better integrating such risks into the EU prudential framework and assessing the suitability of the existing capital requirements for green assets. We will also examine how our financial system can help to increase resilience to climate and environmental risks, in particular when it comes to the physical risks and damage arising from natural catastrophes.

There is an opportunity for lowering capital requirements for green assets (i.e. listed property companies who adhere to the EU Taxonomy).

### **DECARBONISING ENERGY**

The construction, use and renovation of buildings require significant amounts of energy and mineral resources (e.g. sand, gravel, cement). Buildings also account for 40% of energy consumed. Today the annual renovation rate of the building stock varies from 0.4 to 1.2% in the Member States. This rate will need to at least double to reach the EU's energy efficiency and climate objectives. In parallel, 50 million consumers struggle to keep their homes adequately warm. To address the twin challenge of energy efficiency and affordability, the EU and the Member States should engage in a 'renovation wave' of public and private buildings.

#### **6. *Addressing the barriers to renovation***

While increasing renovation rates is a challenge, renovation lowers energy bills, and can reduce energy poverty. It can also boost the construction sector and is an opportunity to support SMEs and local jobs. The Commission will rigorously enforce the legislation related to the energy performance of buildings. This will start with an assessment in 2020 of Member States' national long-term renovation strategies.

The Commission proposes to work with stakeholders on a new initiative on renovation in 2020. This will include **an open platform** bringing together the building and construction sectors, architects and engineers as well as local authorities **to address the barriers to renovation**.

The Commission will also work to lift national regulatory barriers that inhibit energy efficiency investments in rented and multi-ownership buildings. Particular attention will be paid to the renovation of social housing, to help households who struggle to pay their energy bills. Focus should also be put on renovating schools and hospitals, as the money saved through building efficiency will be money available to support education and public health.

### **CLIMATE AMBITION**

#### **7. *Buildings to get included in the European emissions trading system (ETS)***

The Commission will also launch work on the possibility of including emissions from buildings in European emissions trading, as part of broader efforts to ensure that the relative prices of different energy sources provide the right signals for energy efficiency.

#### **8. *Energy Taxation Directive***

The Commission will work to ensure effective carbon pricing throughout the economy. The different pricing instruments must complement each other and jointly provide a coherent policy framework. Ensuring that taxation is aligned with climate objectives is also essential. The Commission will propose to revise the Energy Taxation Directive, focusing on environmental issues, and proposing to use the provisions in the Treaties that allow the European Parliament and the Council to adopt proposals in

this area through the ordinary legislative procedure by qualified majority voting rather than by unanimity.

### *EPRA's engagement, future actions and timeline*

	INITIATIVES	Indicative timeline	EPRA Priority & actions
<b>Renewed sustainable finance strategy (Q3 2020)</b>	1. EU Taxonomy	Ongoing	Ongoing (see previous paragraph)
	2. Review of Non-Financial Reporting Directive	Legislative, impact assessment, Q4 2020	To monitor, review, engage and promote EPRA sBPR
	3. The corporate governance framework	To be determined	To monitor
	4. Adjustment of the EU prudential rules for green assets	To be determined	To monitor, review and determine actions
	5. Green labels and EU Green Bond standard	Ongoing	To monitor
<b>Decarbonising energy</b>	6. Renovation wave	Non-legislative, Q3 2020	EPRA to apply for the participation to the open platform & engage to address the barriers to renovation
<b>Climate ambition</b>	7. Energy Taxation Directive	June 2021	To monitor if inclusion of carbon tax
	8. Emissions Trading System Directive's revision	June 2021	To monitor if inclusion of buildings