European Public Real Estate Association (EPRA)

Participation to the call for evidence – EPBD

31 October 2024

The European Public Real Estate Association (EPRA) represents the listed real estate sector in Europe, and we thank the European Commission (EC) for the opportunity to provide feedback on the article 17 of the Energy Performance of Building Directive (EPBD). We stress that our members, including the major listed property companies and REITs on this continent, appreciate the full dedication from the EC in their willingness to create legislation that is fit for everyone. Most importantly, our members, are also committed to work towards advancing the objectives of the Renovation Wave. We support the idea that private investors and financial institutions have a key role to play in increasing the pace and depth of renovations, by narrowing the gap in timing between the upfront costs of renovation and when the associated benefits are reaped, as well as by acting as trusted partners for building owners at milestones for energy renovations.

However, to do that, certain important clarifications need to be considered for the purpose of the appropriate and encouraging application of the EPBD.

EPRA represents more than 290 members (companies, investors, and their suppliers) and over 880 billion EUR of real estate assets[1] (European companies only) and 95% of the market capitalisation of the FTSE EPRA Nareit Europe Index - including REITs, which are companies that own, develop and trade investment property, to investors whether pension funds, asset management firms and insurance companies – who themselves invest in real estate by purchasing their shares.

Listed real estate is defined as companies that are quoted on an official stock exchange that derive income from the ownership, trading, and development of income-producing real estate assets. Listed real estate allows anyone, retail investors alongside large institutional investors, to invest in the underlying assets of publicly quoted companies, in the same way as investing in other industries through purchasing shares.

They are the guardians of many of the highest-quality assets in Europe's cities: office and retail centres, data centres, industrial facilities, lodging/resorts, residential buildings (student housing, healthcare and senior housing), and other types of properties.

Our members[2] are also pioneering transparency and sustainability in the built environment, by means of meeting their responsibilities towards local communities and the demands of the shareholders to safeguard their investments in the face of the green transition.

[1] Updated in October 2024

[2] Please find here a full list of our membership: https://www.epra.com/about-us/who-we-are/our-members

The building sector is responsible for about 40% of Europe's energy consumption. It is therefore essential to make energy efficient buildings in Europe a priority, including their financing through financial market and institutions. The real estate industry, the second most EU-taxonomy aligned, will continue to play a crucial role in the green transition.

As supported by EPRA members, renovation is a critical part of the listed real estate industry in achieving ESG objectives and advancing towards net zero. To support the energy efficient renovation of Europe's buildings, a suitable regulatory environment is paramount.

We thank the EC for the opportunity given to raise some clarification on the added value of a portfolio framework to guide financial institutions and facilitate access to financing for energy performance renovations of buildings. Furthermore, the call for evidence is also a good opportunity for us, to give our feedback on the potential barriers or obstacles for the financing of energy performance renovation.

Key considerations

Our first key consideration lies on the current financing of energy performance renovation, the role of financial institutions and our industry views on the "voluntary use by financial institutions" of the portfolio framework that will support lenders in targeting and increasing lending volumes;

Our second key consideration lies in the potential barriers and obstacles remaining to enable a better financing of renovations especially how the voluntary framework should not only be for the worst-performing buildings but should include every building of all kind;

Our third key consideration lies in the best practices developed by our industry and how our industry can be considered as best in class due to its listed nature;

Our fourth key consideration lies on the financing transformation of the European built environment as encouraged by the EU Renovation Wave Strategy and how interconnexion between different regulations could help its financing and bring more clarity for investors.

Through our answer, EPRA would like to invite the EC to make sure that sustainability reporting requirements are fit for the real estate sector and especially the listed real estate sector.

First focus: The role of financing institutions in the renovation process and the voluntary framework proposed in article 17 (10) EPBD

EPRA supports the EC's efforts to boost energy-efficient renovations, essential for achieving the Paris Agreement's goals. While this framework does not impose direct requirements on real estate companies, it has significant implications for the sector by influencing financing conditions for building renovations.

Before diving into the details of the regulation and EPRA's feedback, it is important to mention that EPRA, as a member-driven trade association collected its members' opinions in order to build its own. Through a careful reading of the EC's call for evidence together with some of our members, a debate came across on EPRA's necessary participation.

Several companies raised concerns on the targeted audience for the call for evidence. According to some of our members, the call for evidence seemed very much targeted at the market for residential mortgages to individuals rather than on the market for institutional investors / Real Estate Investment Trusts (REITs). The residential mortgage market for individuals stands apart from that for institutional investors and listed real estate, focusing primarily on personal creditworthiness, uniform loan products, and strong regulatory safeguards.

The market for institutional investors and REITs emphasizes the investment potential and income generation of property portfolios, involving larger loans and customized structures such as portfolio loans. While regulatory oversight remains, institutional loans are less prescriptive, as these borrowers are expected to be experienced in such financing structure[3].

We do invite the EC, while developing its future delegated regulation, to be more accurate when defining the scope of application of the future voluntary framework.

EPRA, and its membership, fully supports the process organised by the EC and the liberty given to the different stakeholders for the compliance with minimum energy performance standards by developing financing structures which will provide incentives for deep renovations and staged deep renovations.

To achieve the objectives of climate neutrality, EPRA wishes to highlight the fact that a voluntary framework might lead to fragmented adoption by the different stakeholders which could clearly undermine the framework's overall effectiveness. Some stakeholders may not participate or implement it inadequately, creating disparities that make it difficult to benchmark or compare performance across the industry.

The built environment is a decisive factor when it comes to sustainability. Leading the efforts to improve this will be a key differentiator for European listed real estate companies as sustainability concerns are gaining momentum with tenants and investors. We strongly believe that having a voluntary framework might slow the progress expected. With the current amount of sustainability regulations, financial institutions will prioritize mandatory commitments over voluntary frameworks, which will slow things down.

The EC has set ambitious goals for financial sustainability and climate actions, but relying on a voluntary approach might not be enough to meet these targets. As mentioned above, it might slow things down in reaching the target of 2030 and 2050 as voluntary schemes often lack the rigor or precision needed to drive systemic change and may fall short in addressing the depth of issues the EC seeks to tackle.

Key takeaways

[3] On the other hand, the mortgages for individuals typically involve smaller, standardized loan amounts, assessed based on personal financial factors like income, credit score, and debt-to-income ratios, with common terms of 15-30 years and regulated to ensure consumer protection.

To increase the desired effect of the delegated regulation, we do invite the EC to be more specific while defining the targeted audience of the future framework;

The voluntary nature of the framework may result in fragmented adoption, potentially undermining its effectiveness. To mitigate this, we recommend introducing incentives for financial institutions to adopt the framework consistently, helping to establish uniform standards and promote fair benchmarking across the sector. The EC could inspire itself by several Code of Conducts establish in the financial and non-financial sectors (such as the digital sector).

Focus 2: The potential barriers and obstacles remaining to enable a better financing of renovations especially how the voluntary framework should include the worst-performing buildings but not only

Sub-focus A : Making sure that the delegated regulation will target every building and not only the worst-performing ones

EPRA fully understands and supports the focus on worst performing buildings which ensure that highest savings. Given the wording of the recently adopted EPBD in its article 17(10), a small confusion could be easily made, creating a focus only on the worst performing building.

EPRA and its membership wish to avoid such a misunderstanding because focusing on every building allows for a broader reduction in carbon emissions. Even buildings that are not currently the worst-performing still contribute to overall carbon emissions, and gradual improvements in all buildings can have a cumulative positive effect. A comprehensive approach addresses small inefficiencies in many buildings, which together could represent significant improvements.

By including all buildings, the created framework will encourage a culture of continuous improvement across the real estate sector. This can drive innovation but also boost market confidence by ensuring that all properties meet minimum performance criteria.

EPRA and its membership do consider that a holistic approach will accelerate the transition to a greener real estate market. By improving all buildings, the overall market shifts faster toward sustainability, making it easier to meet long-term goals such as net-zero emissions. EPRA and its members are frontrunner in addressing those issues and many of our members are increasingly focusing on sustainability and energy efficiency, driven by investor demand and market trends. EPRA's members assets often feature green certifications like BREEAM or LEED and they invest in retrofitting older properties to meet sustainability standards, reducing environmental impact.

As EPRA's membership mostly tend to have "best-in-class" assets, focusing only on the worst performing buildings might lower the impact of the delegated act for a significant portion of the RE market.

Finally, by including every building, regulators can avoid a patchwork approach where only certain buildings are targeted, creating complexity in compliance and creates uniform standards that can be applied across the sector, ensuring clarity and fairness.

Sub-focus B: Making sure that the delegated regulation will target every building uses and tenant type

As we mentioned above, the real estate industry is the second most EU-taxonomy aligned industry and is determined to continue to play a crucial role in the green transition. To support the energy-efficient renovation of Europe's buildings, a suitable regulatory environment is necessary. Real estate projects have lifecycles spanning multiple decades from inception to full payoff, and regulatory uncertainty can heighten risks perceptions and discourage investors.

This is why, together with our members, we tend to believe that developing a unified and comprehensive system for Energy Performance Certificates (EPCs) across the EU to ensure uniform standards and terminology, effectively allowing everybody to "speak the same language" and would help the green financing of buildings. Indeed, several companies raised the issue that although the EPC is the main element requested for the green financing of building, in some countries such as Spain per example[4], it does not represent the reality of the energy intensity of the building, since the EPC only includes the office area and not the warehouse area (Spanish case[5])[6].

Acknowledging EPC as a regulatory tool, we suggest using it alongside real operational data to provide a holistic view of a building's real performance. This dual approach will retain EPC's benefits for energy simulation while enhancing accuracy with real-world data, such as energy and CO_2 intensity metrics, which reflect the actual energy consumption of assets.

To ensure EPC's effectiveness across varied asset type, as mentioned above between logistics and industrial buildings, EPRA recommends a harmonized EU-wide standard. This approach would accommodate sector-specific considerations and support real estate companies in consistently meeting EPC criteria, particularly for green financing.

Finally, we do support the inclusion of green financing mechanisms, such as Energy Performance Contracts and on-bill financing, which can de-risk projects and increase financing availability for multiple assets. As banks and institutional investors are governed by the risk-based approach, we do consider that these models might de-risk the renovations projects and facilitate them. These models offer blended funding solutions that appeal to banks and investors alike, fostering broader access to financing.

Key takeaways

We do advocate for a comprehensive framework that includes all building types, not just the worst-performing assets. This approach will ensure broader

[4] We could also mention Belgium or even the Netherlands as an example.

[5] The limitation for EPC for logistics is widespread across Europe and on the contrary, some countries such as Germany cover both the office and storage area. For more information on the different EPC regulation all over Europe please see our interactive map (page 3) created together with the World Green Building Council: https://www.epra.com/application/files/6017/2916/9762/Factsheeet_SFTF.pdf

[6] This exception of industrial site has been present site the 2002 version EPBD in its article 4§3 "Member States may decide not to set or apply the requirements referred to in paragraph 1 for the following categories of buildings: […] temporary buildings with a planned time of use of two years or less, industrial sites, workshops and non-residential agricultural buildings with low energy demand and non-residential agricultural buildings which are in use by a sector covered by a national sectoral agreement on energy performance, […]"

emission reductions by enabling continuous improvement across the building sector. By targeting all properties, the framework can encourage innovation, uniform standards, and boost investor confidence. This also addresses feedback from members who believe focusing only on the worst-performing buildings could create compliance complexities and limit overall impact;

No distinction between the asset use should be done in order to foster the renovation wave;

We do invite the EC to support green financing mechanisms and risks mitigation models such as Energy Performance Contracts or On-Bill financing to foster the renovation financing.

Focus 3: Best practices developed by our industry

As we developed in our introduction, EPRA represents more than 290 members among which two-third of them are listed companies. Listed real estate is defined as companies that are quoted on an official stock exchange that derive income from the ownership, trading, and development of income-producing real estate assets.

Listed real estate and more specifically EPRA's members, can be considered as having "best-in-class" assets in terms of sustainability due to their stringent regulations and transparency requirements they must adhere to, especially under EU frameworks and their listed status.

For a smoother transition, we recommend aligning the framework with widely used metrics in the real estate sector, like CO2 intensity per square meter, as outlined in EPRA's sBPR (Sustainability Best Practices Recommendations) guidelines[7], which provide since 2011 standardized metrics for transparent, consistent ESG reporting in the listed real estate industry.

This alignment would allow real estate companies to utilise existing reporting structures, enhancing ease of adoption and alignment with ESRS sector specific standards anticipated to include similar metrics.

We tend to believe these recommendations will improve the voluntary framework's effectiveness, driving energy efficient renovations across the real estate sector while ensuring compatibility with existing regulatory requirements and industry best practices.

Key takeaways

We do invite the EC to consider EPRA as a trusted counterpart representing a vast number of companies (representing a significant share of real estate assets

[7] EPRA sBPR Guidelines provide a consistent way of measuring sustainability performance in the same way that BPR for financial reporting have made the financial statements of listed real estate companies in Europe clearer and more comparable.
The fourth edition of the guidelines, released in April 2024, is designed to help companies managing the reporting complexities as mandated by the "sector agnostic" European Sustainability Reporting Standards (ESRS), while also making the guidelines more comprehensive.
Access to the guidelines:
https://www.epra.com/application/files/4617/1567/8076/EPRA_sBPR_Guidelines_Fourth_Edition.pdf

in Europe) having at heart to grow in a sustainable society while basing its analysis on EPRA's sBPR.

<u>Focus 4: The coherence between the forthcoming regulation and the already existing regulation</u>

<u>Sub focus A: Coherence with the wider banking regulations</u>

Considering a bigger picture might help find the sources of the lending limitations by financial institutions. Basel IV requires banks to hold more capital against riskier assets. Lending for CapEx, including refurbishment loans, is generally considered as riskier compared to financing stable, income-generating assets. Consequently, the capital requirement for CapEx loans can be prohibitive, meaning banks must allocate more capital to cover the risk of such loans. The requirement makes CapEx lending less attractive as it reduces banks' profitability on these loans.

This is one of the reasons why financial institution prefer to finance renovated assets which are considered as a more stabilised assets. Financing post -refurbishment, rather than during, aligns with Basel IV's emphasis on reducing exposure to asset classes that may be uncertain in terms of completion and value. In contrast, loans for renovation introduce uncertainties regarding construction timelines, cost overruns, and post-renovation property values, making such loans riskier under regulatory metrics.

The European Central Bank (ECB) have recently increased scrutiny on the energy efficiency of real estate assets held on banks' balance sheets[8]. Banks that hold loans secured by non-refurbished, lower-energy-efficiency assets face added regulatory pressure, especially as EU climate goals push for a greener building stock. However, while banks recognize the long-term value of financing greener assets, the upfront cost and regulatory risk of funding renovations directly disincentivize them from lending for this purpose.

<u>Sub focus B: Coherence with the different sustainability regulations</u>

- Coherence between SFDR and EPBD

In listed real estate, investors (financial market participants) invest in the underlying real estate assets through a listed real estate company and are thus treated by the existing Sustainable Finance Disclosure Regulation (SFDR) as an investment in investee companies. However, the fundamentals of the business are determined by the underlying asset, which is a real estate asset.

Even though, the existing SFDR imposes obligations to disclose how sustainability risks are integrated into investment decisions, providing clear and transparent sustainability metrics, we do consider that a clear alignment between the EPBD and the SFDR

[8] See
Financial Stability Review, European Central Bank, May 2024 (https://www.ecb.europa.eu/press/financial-stability-publications/fsr/html/ecb.fsr202405~7f212449c8.en.html)
Financial Stability Review, European Central Bank, November 2023 (https://www.ecb.europa.eu/press/financial-stability-publications/fsr/html/ecb.fsr202311~bfe9d7c565.en.html)

including relevant indicators that improve the measurement and disclosure of energy transition advancements when adopting the delegated act based on article 17(10) EPBD and developing a labelling framework that introduces a category specifically tailored to facilitate a transition strategy in real estate, would clearly help our sector and ultimately its renovation financing.

With the current list of indicators for real estate established in the SFDR, it is not possible to demonstrate the transformation / decarbonisation of an investment portfolio / financial products as anticipated in Article 9 (3) SFDR (*see EPRA's response to the Targeted consultation on the implementation of the SFDR, December 2023*[9]). Indeed, the current existing set of *Principal Adverse Impacts* (PAIs) almost contradicts the nature of transition finance or impact investing sought after within Article 9(3) SFDR. This contradictory nature is perfectly illustrated by the energy efficiency of buildings (a mandatory indicator) under the real estate category. The logic behind this indicator, is to demonstrate that the Financial Market Participant (FMP) is causing significant harm by investing in energy-inefficient buildings, as opposed to those that are energy-efficient.

However, the main purpose of investment decisions for decarbonisation in real estate is to acquire energy-inefficient buildings and conduct energy renovations to improve their energy performance. In this context, financial products seek to decrease the existing Greenhouse Gas (GHG) emissions of the buildings, rather than simply causing significant harm, as suggested by the current logic of the selected PAIs under the SFDR that are mandatory for real estate investment.

To enable financing incentives into the renovation of buildings, EPRA and its members recommends a better alignment between the EPBD and the SFDR especially through the opportunity given by the future delegated act but also through the next review of the SFDR.

In this context, we advise considering several indicators which could help narrowing the two regulations – (i) considering the reduction of CO_2 intensity/year or sqm turned from non-efficient to efficient property or (ii) but only for operational property adding a CapEx plan for Taxonomy alignment. However, these indicators are not to demonstrate an adverse impact on the environment/society but the actual progress of the products in decarbonisation. The rationale behind these indicators is that building energy intensity is one of the most effective measures of a building's overall energy efficiency during the occupation and operational phase of the building's life cycle. It enables an analysis of performance over time without the need to exclude acquired or sold properties.

Building energy intensity is primarily intended to track changes over time for the reporter's assets and is thus very suitable to observe improvements in the companies' property portfolio on energy efficiency.

This measurement is based on actual data, unlike the EPCs, which are based on estimated data, making it more meaningful to investors. The total CO_2 intensity is then used to describe the real estate sector's impact on climate change and is, in fact, the most desired performance metric by investors and non-financial rating agencies.

- Coherence between the EU Taxonomy and the EPBD

[9] https://www.epra.com/application/files/1017/0732/0576/SFDR_Targeted_Consultation.pdf

As mentioned above, to support the energy efficient renovation of Europe's buildings, a suitable regulatory environment is paramount. It entails two key actions. First, ensuring that any additional new legislation is weighed against the needs of long-term investors and businesses is crucial to providing the market with a stable regulatory landscape. Indeed, real estate projects have lifecycles spanning multiple decades from inception to full payoff, and regulatory uncertainty can heighten risk perceptions and discourage investors especially when they must invest in deep renovations. Second, refining the existing framework to better accommodate the specific needs of the energy transition for real estate assets.

A way to help financial institutions increasing their lending volumes provided for energy performance renovations is obviously to ensure regulatory simplification through an alignment between the EPBD and the EU Taxonomy regulation to ensure the EPBD's worst first approach' philosophy is mirrored in the EU Taxonomy.

Indeed, integrating real annual energy performance measurements into the EU Taxonomy framework would clearly help investors to better understand the true climate impact of the assets in their portfolio.

EPRA, would like to underline the persisting uncertainty in the market regarding how energy renovations are viewed as non-sustainable activities. This element is clearly a barrier for financial institutions to increase their lending volumes. The reduction in carbon emissions in real estate is primarily achieved by transforming existing building stock, improving its energy performance, and decreasing its carbon emissions. We stress that reducing carbon emissions of investment property within EPRA members' portfolios (and beyond) would significantly contribute to achieving the long-term global warming objectives of the Paris agreement. Several tools exist to help the sector plan its transition pathways, calculate performance and report on progress, among which is a previously EU funded tool called the CRREM project.

Key takeaways

In order to encourage financial institution increasing their lending opportunities, we do invite the EC to have a closer look at the bigger picture of banking regulations, especially the Basel IV framework

To enable financing incentives into the renovation of buildings, EPRA and its members recommends a better alignment between the EPBD and the SFDR especially through the opportunity given by the future delegated act but also through the next review of the SFDR.

To achieve the goal of the future delegated act, we propose that the EC clarify in the EU Taxonomy Climate Delegated Act that for the real estate sector, portfolios of investment property with clear objectives to transform the existing building stock, improve energy performance, and reduce carbon emissions are sustainable investments.

EPRA encourages the EC to actively engage in consultation with our industry when shaping the upcoming delegated act and the future SFDR. While drafting the future delegated act there is a clear need to differentiate between the different kind of companies but also between the size of the company and between the kind of investors. Such collaboration is essential for developing a suitable framework that effectively address the unique considerations and challenges within the real estate domain.