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Executive Summary

ESG takes center stage: How does this affect the real estate industry?
Regulators mandate it, investors demand it, society expects it: Sustainability has become a strategic imperative across industries. Considering the fact that buildings account for 40 percent of energy consumption and 36 percent of CO_2 emissions in the European Union (EU), it comes hardly as a surprise that the real estate sector's climate impact is under intense scrutiny. As a consequence, a host of new rules and regulations have already come into force, focusing on the three ESG dimensions Environmental, Social and Governance. Accordingly, industry leaders are confronted with a panoply of pressing decisions in order to navigate the increasingly complex regulatory landscape and to meet the expectations of societal stakeholders. At the same time, astute ESG strategies also open up attractive new avenues for growth and value creation for the sector, and lead the way to an ESG-proof business. This report presents ten expert contributions in which industry and ESG specialists from Deloitte discuss the manifold implications and opportunities for an ecosystem of financiers: Financiers, owners, property developers, investors, REITs, facility and asset managers. A major topic of discussion is of course the evolving regulatory landscape, where the EU is surely the most important actor as it pursues its goal of climate neutrality by 2050. The first contributions in this report focus on the new Sustainable Finance Disclosure Regulation (SFDR) and the real estate aspects of the EU Green Deal. Looking at operational and strategic implications, experts also discuss ESG investment management strategy implementation, ESG tax governance, and challenges in ESG data management. A separate section is dedicated to the important ways in which ESG can act as a value driver for the industry. Furthermore, when weighing up ESG imperatives and opportunities, it is crucial to embrace a holistic perspective, as another contribution underlines. This perspective needs to include the "S" and the "G" in ESG as well as the "E": In addition to pressing environmental issues such as climate change, social and governance issues must not be neglected in order to work towards a truly sustainable strategy for real estate players. Further contributions discuss the increasing importance of green lease arrangements and the challenges of the decarbonization of real estate across the complete asset life cycle.

We wish you many interesting insights while reading and will be happy to answer any questions you may have.

Kind regards,

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Article #1 –
Sustainable Finance Disclosure Regulation (SFDR) in the real estate industry

Real estate industry players are facing new EU sustainability regulations such as the Sustainable Finance Disclosure Regulation (SFDR) and the Taxonomy Regulation.

The SDFR establishes important ESG disclosure obligations, such as website disclosures (corporate level), pre-contract disclosures and website disclosures (fund level). However, some questions as to the regulatory scope e.g. non-EU and registered AIFMs still remain open.

A main practical challenge that the SFDR implies is data collection about ESG impact and risk, including along the value chain (e.g. fossil fuel exposure, energy-inefficient assets exposure).

Dedicated resources are necessary in order to integrate related risks into established processes, yet asset managers may also reap benefits, for instance through product differentiation.

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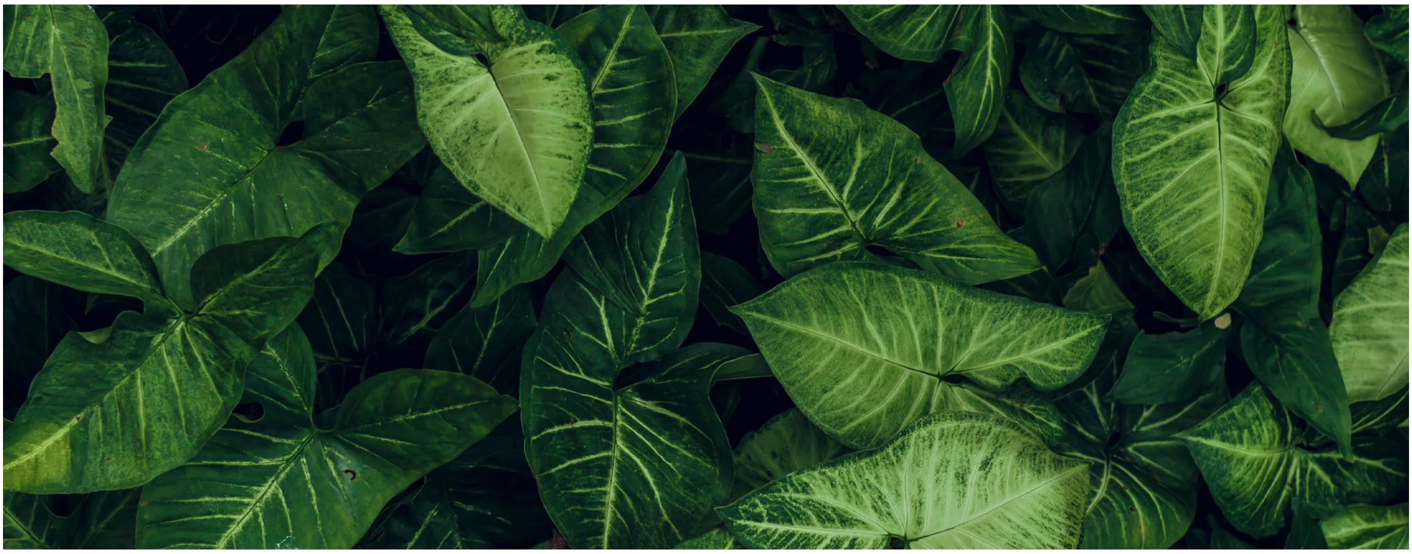

Discover the key steps and challenges for real estate asset managers to comply with the SFDR by March 10, 2021.

Regulators, investors, stakeholders and the public in general are increasingly holding businesses accountable for sustainable practices. The growing relevance of sustainability issues is also driven by recent legislative developments which reflect the urgency to mitigate environmental risks related to climate change.

The scope of the regulatory framework

The publication of the EU Action Plan on Sustainable Finance in March 2018 has significantly raised awareness on sustainability issues in the real estate industry. As part of the EU Action Plan on Sustainable Finance, two key EU regulations were published with the aim to provide transparency and harmonization to sustainability within financial markets:

1. The EU Sustainable Finance Disclosure Regulation (SFDR) – also known as the Disclosure Regulation – requires the disclosure of sustainability-related data and policies at entity and product level.

Certain real estate asset managers and other investment products and/ or product manufacturers of real estate investments are included in the scope of this regulation.

The SFDR applies to certain financial products and extends to their product manufacturers and their financial advisers who are located in the EU:

- Alternative investment funds (AIFs) and UCITs
- Portfolios managed by credit institutions or investment firms
- Managers of a qualifying venture capital fund
- Insurance-based investment products (IBIPs)
- Pension products, workplace pensions products regulated under the IORP directive and PEPPs

Questions have been raised to the European Commission (EC) by the European Supervisory Authorities (ESAs) as a result of consultation process with major stakeholders regarding the applicability of the SFDR to non-EU AIFMs and registered (also referred to as subthreshold) AIFMs. These questions are still unanswered as of the date of this article. It is, however, the market's view that subthreshold AIFMs are excluded from the scope of SFDR and that non-EU AIFMs that market AIFs in the EU must comply with product-level disclosure requirements.

The SFDR consists of the following measures:

- Regulation (EU) 2019/2088 (SFDR) (also referred to as "Level 1")– sets out the framework principles to establish harmonized transparency rules on sustainability risks and adverse impact on sustainability factors. These principles are applicable from March 10, 2021.
- The newly published Regulatory Technical Standards (RTS) (also referred to as "Level 2") – supplement level 1 with greater details, clarifications and structure. The RTS specify the content, methodologies and presentation of information in relation to sustainability indicators and the promotion of environmental or social characteristics and sustainable investment objectives in pre-contractual documents, websites and periodic reports. The RTS will come into force from January 1, 2022 (see previous regulatory news[1]).

This means that, until the more detailed RTS will apply on January 1, 2022, the SFDR compliance will be more qualitative and "principle-based", leaving managers some time to adapt and build up their sustainability strategy for the more stringent requirements coming in 2022.

2. The Taxonomy Regulation 2020/852 has already entered into force, with most of the requirements being applicable starting from January 1, 2022, and requires that economic activities considered environmentally sustainable are to be defined and classified so that the degree of environmental sustainability of an investment can be determined. This Taxonomy thus provides investors with guidance on which activities are environmentally sustainable and which are not. It is aimed at preventing "greenwashing" and ensures a systematic and comparable approach to environmentally sustainable investments.

With buildings being responsible for approximately 40% of energy consumption and 36% of CO_2 emissions in the EU[2], the relevance of SFDR to the real estate sector is indisputable.

The SFDR disclosure requirements by March 10, 2021 in a nutshell

The respective disclosures that should be made on the website of the entities in scope and the pre-contractual documentation of the products they manage can be summarized as follows:

Website disclosures: Corporate level (Articles 3–5)

- Describe how sustainability risks are integrated into the investment decisionmaking process and remuneration policies.
- Either:
  - publish a statement on the due-diligence policy relating to the "principal adverse impacts" (PAIs) – deleterious effects of investment decisions on environmental and social criteria,
  - or publish clear information on why it is not doing so. (Referred to as the "comply or explain" approach)

However, from June 30, 2021, firms with more than 500 employees will not have a "comply or explain" option anymore and must disclose their PAIs on sustainability factors and summary of engagement policies on their websites. Of the 18 mandatory principal adverse sustainability impact indicators, two are specific to real estate.

Pre-contractual and website disclosures: Fund level (Articles 6–11)

- Describe how sustainability risks are integrated into the investment decisionmaking of the product funds.
- Either:
  - articulate the impact of these risks on the return of all of their products, including those funds that do not promote any sustainability factor,
  - or explain why the sustainability risks are not relevant to the fund.
- For products that promote environmental and/or social characteristics ("Art. 8 products") and those which have sustainable investment as their objective ("Art. 9 products"), disclose how these characteristics or objectives are met and provide information on any index designated as a reference benchmark.

Further disclosures are required in the annual report and website from January 1, 2022 relating to the extent to which the environmental and/or social characteristics of the fund are met (for Art. 8 products), information on the overall sustainability impact of the fund (for Art. 9 products) and environmental objectives and other supplemental disclosures under the Taxonomy Regulation.

From December 2022, managers must also disclose in the fund prospectus whether and, if so, how, they consider principal adverse impacts for each of their funds. If the managers do not do so, they must explain for each fund the reasons why they do not consider principal adverse impacts to apply.

SFDR opportunities and challenges in the real estate industry

These regulations create both opportunities and challenges for real estate asset managers: Opportunities for product differentiation, not only in relation to the environmental aspect but also with respect to the social impact of real estate projects on people, particularly low-income and vulnerable populations in need of support and stability; and challenges, when it comes to real estate asset data gathering to meet these disclosure requirements and in identifying the necessary resources and expertise for effective integration of sustainability risks in their due diligence policies and processes.

Along with the real estate asset managers there is an ecosystem of investors, financiers, partners such as property and facility managers, as well as external providers of real estate products such as project developers and suppliers of building materials that constitute the real estate value chain. Although the SFDR directly impacts the real estate asset managers, reporting and transparency in relation to sustainability must be achieved along the entire length of the value chain.

The impact of sustainability risks is determined not only by operating real estate properties, but also by the investment strategies and fund management activities. Fund and asset managers must interact closely with the operating participants of the value chain in order to face the challenges of data gathering and sustainability impact measurement and meet the new disclosure requirements. The SFDR creates expectation from every player in the real estate value chain to support the funds' product differentiation and sustainability strategies in their own policies and operating practices.

As noted earlier, two of the 18 principal adverse sustainability impact indicators to measure the PAIs are specific to real estate. One indicator is the exposure to fossil fuels through real estate assets, measured as the share of investments in real estate assets involved in the extraction, storage, transport, or manufacture of fossil fuels. The second indicator measures the exposure to energy-inefficient real estate assets. Real estate asset managers will have to look for the appropriate resources and expertise to be able to measure these indicators and comply with the regulation. The lack of consistent and comparable data across countries for benchmarking building performance and setting suitable thresholds for the top performing buildings represent a challenge for the required measurements.

Disclosing the due-diligence policies relating to PAIs will be mandatory for firms with more than 500 employees starting from June 30, 2021. Another challenge resides in the interpretation of this aspect of the regulation and what criteria will have to be used to determine whether a real estate asset manager falls within the 500 employees threshold.

As highlighted in a survey conducted by Deloitte at the end of 2020, in the coming months, real estate asset managers will have to redefine their internal processes and governance to effectively transform mere compliance to regulation into strategic management. Examples of the transformations include the fact that they will have to strategically choose their product categorization with respect to sustainability by drawing a "SFDR roadmap" in both the short and the long term. The SFDR roadmap and monitoring of the product categorization will become part of the new operating model of real estate asset managers.

They will also need to identify the data stream they will use and determine the appropriate scoping, analysis and reporting. The data gathering process for financial data is already a challenge considering the diversification of the real estate asset locations and numerous data sources inherent to the data flow – and an efficient data gathering process will surely remain a challenge for non-financial data as well.

It is therefore essential that real estate asset managers react quickly to face the challenges raised by the SFDR.

Article #2 –
European Green Deal
What's in there for real estate companies?

Aiming for climate neutrality by 2050, the EU Green Deal involves a significant redirection of private capital flows to help with greenhouse gas emission reductions.

The real estate industry will be affected in several ways, particularly by a push for higher renovation rates, as existing buildings are ageing and largely not energy efficient. The EU plans to double the renovation rate in the next ten years.

The recently introduced EU sustainable finance taxonomy establishes reporting obligations for many real estate companies. Disclosures on turnover, Capex and Opex will be of significant relevance for investors in real estate companies to structure their investment decisions. The taxonomy is also the foundation of EU green bond standards.

In the near future, a makeover of the directive on non-financial disclosure is to be expected, potentially expanding the scope of affected companies.

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The European Union is set to be climate-neutral by 2050. Therefore, far-reaching measures are taken to decarbonize the European economy. The real estate sector is in focus, as buildings are responsible for 36% of CO_2 emissions in Europe. The Green Deal is strategically relevant for real estate companies – it will impact business models, market demand and financing conditions.

Through the Paris Climate Agreement in 2015, the United Nations committed to limit global warming in the 21st century to less than 2°C, if possible less than 1.5°C, and to succeed with that goal to reduce global CO_2 emissions by 80–95% by 2050, which would result in a far-reaching decarbonization of the global economy.

The achievement of these climate targets (but also other sustainability targets) is being intensively pursued at EU level through the European Green Deal and the EU Financing Sustainable Growth Action Plan: By 2050, Europe should be climate neutral. To achieve this, greenhouse gas emission targets for 2030 are to be reduced by 55% compared to 1990. According to research by the EU Commission, buildings are responsible for about 40% of the EU's energy consumption and 36% of CO_2 emissions from energy. Further measures concern sectors such as mobility, food production and chemicals. To finance this, private capital flows of 180–290 billion Euros per year shall be redirected to sustainable investments or uses. Overall, the EU is pursuing six environmental objectives:

1. Climate change mitigation
2. Climate change adaption
3. Sustainable use and protection of water and marine resources
4. Transition to a circular economy
5. Pollution prevention and control
6. Protection and restoration of biodiversity and ecosystems

To meet these objectives, the EU Commission has introduced several farreaching measures, of which the following seem particularly relevant for real estate companies:

EU renovation wave

According to the EU Commission, more than 220 million building units (85% of the EU's building stock) were built before 2001. The EU Commission expects 85–95% of the buildings that exist today will still be standing in 2050. Given the EU's decarbonization goal and that most of these buildings are not energy-efficient, the Commission is convinced that it is necessary to double renovation rates in the next ten years to provide for higher energy and resource efficiency. By 2030, 35 million buildings should be renovated, which would also create 160,000 additional green jobs.

EU sustainable finance taxonomy

Real estate companies that have to prepare non-financial reports in accordance with the non-financial reporting directive will have to disclose the proportion of their turnover, Capex and Opex derived from construction, renovation, acquisition or ownership of buildings, that substantially contribute to climate change mitigation. It is therefore necessary to meet demanding criteria concerning primary energy demand, air-tightness and thermal integrity as well as life cycle global warming potential. Moreover, the activities may not significantly harm neither the other five EU environmental objectives nor minimum safeguards for workforce safety and human rights. In addition to energy efficiency targets, real estate companies will be required to meet ambitious goals regarding water consumption, circular economy (at least 70% of non-harzardous construction and demolition waste shall be prepared for re-use, recycling and other material recovery) as well as pollution goals. These disclosures on turnover, Capex and Opex will be of significant relevance for investors in real estate companies to structure their investment decisions and as a basis for their own taxonomy reporting obligations as of the SFDR. The taxonomy criteria furthermore form the basis of the EU green bond standard.

EU non-financial reporting directive

The directive is currently being revised. The new rules are expected to be applicable from FY 2023 onwards. The Commission is set to enlarge the scope of companies that have to prepare nonfinancial statements in accordance with the Directive, from large listed companies with more than 500 employees to all large companies – these companies would then also have to fulfill the taxonomy disclosure requirements.

Article #3 –
Real estate investment management in the light of ESG

In the current situation, real estate investment managers (REIMs) urgently need to integrate ESG aspects into their long-term strategies in the light of new regulations and changing markets.

Beyond mere compliance, the resulting transparency and comparability of funds and products affords managers new growth opportunities.

To start the journey and achieve a future-proof organization, REIMs should determine their ESG ambition level, and then develop products and align processes accordingly.

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How to navigate through the ESG jungle to define and implement a future-proof organization.

Over the past years, the relevance of real estate funds with an ESG-focus has increased. While some players managed to establish themselves successfully as sustainable Real Estate Investment Managers (REIMs), others only did little to prepare their organizations for this shift.

With regulatory compliance being the first priority, some players dedicated a large part of their recent efforts ensuring the required regulation is implemented – which felt more like a box ticking exercise rather than incorporating the ESG potential in their long-term strategy. However, one thing is clear: REIMs must react now to create a profound basis for their future business. Having realized this, the first step includes the definition of an individual ESG ambition level – meaning, REIMs have to define whether and to what extent they aim to integrate ESG criteria across their value chain. These questions go way beyond regulatory considerations.

To comply with the Paris Agreement, the global average building energy intensity per square meter must shrink by at least 30% by 2030[1] – a massive undertaking. Therefore, the sector is in the spotlight of politicians and regulators, experiencing a continuous pressure for mitigation efforts.

Besides tightening building regulations (e.g. Energy Performance of Buildings Directive), REIMs experience extended disclosure obligations according to the Sustainable Finance Disclosure Regulation (SFDR) and the EU Taxonomy (see also ESG RE Insights article no. 1). Enforcing a higher transparency and setting the criteria for a common definition of activities that are environmentally sustainable, those regulations allow for better comparability of investment products. They set a new pace for the industry, requiring REIMs to align their business.

However, not only regulations drive the industry to shift towards more sustainable and transparent strategies. Two years ago, a study conducted by UNEP FI, Brentall Kennedy & REALPAC among 44 fund managers, asset managers, and REITs representing more than USD 1 trillion assets under management, found 83% of the respondents to experience an increase in investor demand for sustainability performance disclosure[2]. Since then, we saw this trend progressing steadily. Our expectation therefore is that the number of ESG or impact products will rise and that sustainable strategies will accelerate even further, with conventional funds being put under pressure as the offer of green funds increases.

One thing is clear: to account for this market shift, REIMs must define and implement a sustainable strategy to create a profound basis for their future business.If not, they may suffer from reputational damage and decreasing investor demand. While not suggesting a REIMs offering should purely focus on ESG-impact products, it rather implies that investment managers need to ensure having a clear vision on to what extent they aim to implement ESG in their products, assets, and their organization.

What we currently see on the market is that many REIMs are trying to establish themselves as "ESG players". In some cases, this is strongly driven by the ambition of labelling products as green (e.g. according to article 8 or 9 of SFDR), but lacks a clear long-term concept involving the entire organization. With regulatory compliance being the first priority, operationalising a long-term strategy in some cases falls out of sight. It seems as if some players in the industry dedicate a large part of their efforts to extinguish fires caused by new regulatory requirements and a long-term denial of the topic's importance.

Defining a sustainable ESG-strategy considering a REIMs individual ambition level

To unravel these circumstances, defining a sustainable ESG-strategy on company, product, asset, and data level is key. Preliminary task should be the definition of an individual ESG ambition level, meaning REIMs should define whether and to what extent they aim to integrate ESG criteria across their value chain. Key questions to answer within that stage are:

(a) Does the REIM want to manage/sell ESG products?

(b) Does the REIM want to act solely as an adopter or does the company aspire a pioneering role?

Setting the grounds for strategy implementation

With that being answered, the ESG strategy should be derived in-line with the individual ambition level. This includes the definition of concrete measures across the entire value chain. While players who do not want to focus on managing/selling ESG products only need to comply with certain regulatory requirements (e.g. disclosure requirements according to SFDR), adopters or pioneers should already consider measures that go beyond that (see fig. 1). In a second step, defined measures should be prioritized, linked to a realistic timeline, and assigned to resources. Finally, it is key to establish a steering model that enables the measurement of performance and success during and after the implementation.

Altogether, REIMs defining and implementing a concrete ESG strategy will set the grounds for a future-proof organization and gain competitive advantages. We clearly see those with a mature ESG organization increasing their attractiveness to various stakeholders: from employees to investors and tenants. Hence, as REIMs navigate through the ESG jungle the big picture in defining and implementing a future-proof organization should be considered – instead of focusing purely on regulatory compliance.

Fig. 1 – ESG ambition levels incl. obligatory and voluntary measures on company, product and data level (non-exhaustive list of examples)

Minimum ESG — Adopter — Pioneer

Minimum ESG	ESG Adopter	ESG Pioneer
· Only offering conventional products · Avoiding compliance conflicts and mitigating reputational risks · Complying with regulatory minimum requirements	· Besides conventional products, offering article 8 and 9 products according to SFDR · Clear definition of ESG strategy incl. vision and concrete initiatives · Definition of central ESG responsibilities · Training relevant employees to establish ESG knowledge · Non-financial reporting according to NFDR, SFDR reporting, Taxonomy reporting, and TCFD · Participating in external ESG-scoring · Providing option for green leases · Organising the data collection by defining clear processes and responsibilities, and creating the technical and legal basis for data gathering · ...	· Only offering article 8 and 9 products according to SFDR Similar to ESG Adopter plus: + Integration of ESG along the entire value chain + Regular external ESG-audits + Embedding ESG responsibilities among C-levels + Actively pursuing latest ESG trends and setting the pace for the industry + Integrating ESG criteria in salary models + Managing servicers according to their ESG targets (bonus/malus system) + Executing extensive analyses based on ESG data and deriving concrete measures for property management + ...

Article #4 – Deriving business value from a sustainable tax governance

Real estate industry players may increase portfolio and brand value by introducing integrated ESG tax governance structures and control frameworks, while making sure they meet future transparency and disclosure requirements.

At the same time, real estate companies should develop effective ESG strategy and tax governance approaches. Proactive strategies will unlock benefits such as participation in tax policy discussions, brand building, tax incentives, reduced tax risks and decreased insurance premiums.

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When governance models are reviewed by real estate players to achieve their ESG goals, it also integrates an important tax dimension – tax transparency – which requires the production of data on tax governance and a control framework and which is in many cases not yet available. Real estate players have an opportunity to increase the value of their portfolio and their brand by taking pre-emptive actions to set up a tax governance as part of their overall ESG strategy.

Robust governance models which include transparency reporting have become the cornerstone of the EU policy agenda, attracting tax in corporate ESG strategies. There are currently few legal requirements for businesses to be publicly transparent regarding taxes beyond pure financial reporting obligations. However, there are a significant number of voluntary best practices such as Global Reporting Initiative[1] and the World Economic Forum[2], etc. As from 2021 onwards, tax transparency will be embedded in sustainability reporting regulations. Businesses will have to report about tax at two levels, one for financial reporting purposes to their shareholders, and a second for sustainability reporting purposes to a much wider base of stakeholders, including investors, media, NGOs and the general public. EU Public Country-by-Country tax reporting is well underway to become a reality and would require multinational enterprises to publicly disclose certain tax information for the countries in which they operate. Under the EU Sustainable Finance Disclosure Regulation, financial market participants and financial advisers must disclose sustainability risks in all investments, notably with respect to companies' good governance practices and in particular to tax compliance. These transparency obligations would require businesses to produce data on their tax governance which is in many cases not yet available (e.g. description of the approach to tax and how it is linked to the business and sustainable development strategies of the organization, description of the assurance process for disclosures on tax, etc.). The challenges and opportunities raised by sustainability in relation to tax requires businesses to anticipate, adapt, and act proactively by developing and mastering tax governance and tax communication, which are interdependent.

In this evolving and complex environment, with increasing tax risks and double taxation, businesses are facing growing pressure for tax transparency. Society and stakeholders require them to explain and demonstrate the sustainability of their tax governance and control framework in order to fulfill their tax obligations (i.e., to explain their strategy and approach to tax management). Communication regarding taxation is an important and constituent part of an ESG governance strategy, but it is a highly technical subject that may be challenging for all stakeholders to fully grasp. From a nice to have it is becoming an obligation in 2021.

The setting up of the tax governance function and the processes required will take time and will need resources in respect to notably people, processes, data, tools and technology. And tax governance can no longer be considered in isolation from a broader business and ESG strategy. Anticipating and understanding the tax landscape, as well as setting up a tailored tax governance and control framework will also allow taxpayers to participate in tax policy discussions and share their experience and point of view to lawmakers.

The ability to produce data and to communicate effectively about tax strategy and tax governance to the public and policymakers is positively impacting businesses (e.g. strengthened brand attracting more investors, opportunities to qualify for tax incentives, environmental taxes, etc.). Other immediate benefits from a robust tax governance are the reduced tax risks and associated costs, including decreased insurance premiums. Hence, the value and return on investment for investors and shareholders in companies with a mature tax governance and control framework would increase.

The overall ESG rating and reputation of both businesses and their investors would be improved, strengthening their brand. It is now time to act on this opportunity offered to real estate players to generate value in relation to tax by creating an integrated ESG tax governance.

Article #5 –
ESG data management in the real estate industry

Strategies for ESG transparency and compliance require solid data foundations, and this is why real estate companies should strive to establish a single data model and define key ESG metrics. However, collecting, harmonizing and aggregating real estate ESG data entails a number of challenges:

The variety of asset types and technologies deployed in properties for tracking data (e.g. energy consumption) increases the complexity of data integration across the portfolio.

Different calculation methodologies, metrics and indicators used across jurisdictions imply a step of transformation to align the raw data collected from different assets and from different countries to one single data model.

The picture is complicated further by the partly qualitative nature of social and governance metrics as opposed to mainly quantitative environmental metrics, making it difficult to derive unified ESG KPIs. At the same time, managers should be able to drill down from KPIs to individual assets and identify the ESG impact each asset has at portfolio level.

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ESG – yet another data management challenge for the real estate industry?

ESG challenges are becoming a higher priority for businesses across the real estate sector, making data management more important than ever. Achieving a single data model and defining the key metrics for ESG are issues real estate players can no longer afford to ignore.

With both real estate investors and regulators demanding more sustainability disclosures, players in real estate investment management ("REIM entities") – from property development and/or investment companies to REITs and real estate asset managers – need to focus their efforts on the related data management challenges. This includes agreeing to a single data model and defining key ESG metrics with the aim of achieving uniform, transparent reporting on ESG performance. There are three key areas to address: the complex nature of real estate investment platforms (both in terms of structure and jurisdiction), a lack of maturity in data management and the need for robust technology solutions.

The complex nature of real estate investment platforms

Investment strategies in real estate are more complex than asset classes such as private equity, which have much leaner structures. The different layers, jurisdictions and actors on real estate investment platforms pose challenges when it comes to retrieving environmental, social and governance (ESG) data for reporting purposes.

With real estate assets, actors and vehicles domiciled in different jurisdictions, entities such as TopCo, HoldCo, PropCo, joint ventures and others are subject to different regulations and standards.

This layering and diversity accentuate the challenges faced by REIM entities required to report on their ESG performance.

Collecting the necessary data is nott he only difficulty they face – data harmonization and aggregation promisesto be even more challenging.

Data collection

One difficult aspect of collecting data for ESG reporting is the variety of asset types (i.e., commercial, residential, hotel, logistic, retail, office, etc.), which each use a different data management system. The availability of automated data collection and reporting tools is a huge factor here. For example, some offices may be equipped with Internet of Things (IoT) technology to monitor energy consumption and other data. When this is integrated with facilities or building management software, businesses will have the ability to measure structured ESG metrics, especially in terms of environmental impact. Other type of assets, especially in the logistics area, may use different software systems, may only offer measurement tools in new builds or may be unable to leverage the same level of technology or to collect data with the same frequency, type and granularity.

The degree of data granularity needed to calculate ESG Key Performance Indicators (KPIs) poses additional challenges. For example, collecting data by unit and for every single tenant is much more complex than collecting asset-level data that disregards tenants. And to ensure the ESG KPIs are consistent, REIM entities will likely have to capture data with the same degree of granularity across the property portfolio.

The disparity between E, S and G metrics also plays a big role in the data collection challenges. According to a recent internal analysis by Deloitte, 45% of the data collected and reported by REIM entities relate to environmental metrics, 37% to social metrics and 18% to governance metrics. Environmental data such as carbon emissions, for example, are more quantitative and therefore measurable, making it much easier to capture and report. Social and governance metrics such as freedom of association or exclusion principles, on the other hand, are more qualitative and declarative, which makes them more difficult to monitor.

Other factors that can complicate the data collection process are the country of origin and jurisdiction of various entities and players, whether it is the assets themselves, related asset-level counterparties (i.e., property managers, agents, suppliers, contractors, tenants, etc.), asset and portfolio managers, investors/limited partners or investment vehicles. Disparities in the disclosure requirements, regulations (e.g., authorization to access and use data) and data security of these jurisdictions may restrict access to information as well as information flows. This is particularly true when ESG reporting requires tenant information and other personal data. Defining data standards, such as the formulas for unit measurement, will also require special attention depending on the country in question. Lastly, language barriers may make communication and comprehension more difficult when data is shared across borders.

The complex layering of the investment structure and the actors involved at each layer will impact ESG data collection as well. All stakeholders may be using different technology platforms to collect, record and monitor their data. When it comes to integrating data at the portfolio and investment platform level, having a different degree of granularity or a different reporting template may pose problems. It is crucial for REIM entities to define standards for data collection, which will help them and their servicers to clarify, align and ease the process. This will also be a key step in addressing the second challenge: data harmonization and aggregation.

Data harmonization and aggregation

Once REIM entities are able to collect and retrieve data from all the relevant layers in the real estate investment platform, they will face a second challenge: data harmonization and aggregation.

Aggregating and harmonizing qualitative and quantitative data is by nature a complex endeavor. Most ESG data is non-financial and may in some cases – especially for social and governance metrics – be more qualitative than quantitative. This makes it difficult to draw precise conclusions for the decisionmaking process.

With different calculation methodologies, metrics and indicators used across jurisdictions, there must be a system in place to align the raw data collected from different assets and from different countries into a single data model to derive the ESG KPIs. This is yet another data set for REIM entities to manage, in addition to the effort they are already putting into aligning, monitoring and validating the data they collect for other purposes.

REIM entities should also make sure they have the capacity to drill down from an ESG KPI to the asset level, so that they can identify the impact or weight of each asset for the portfolio as a whole. This highlights how important it will be to trace individual elements of aggregated data points and provide users the possibility to navigate up and down the investment structure at the asset, portfolio and investment platform levels.

Solutions and future opportunities

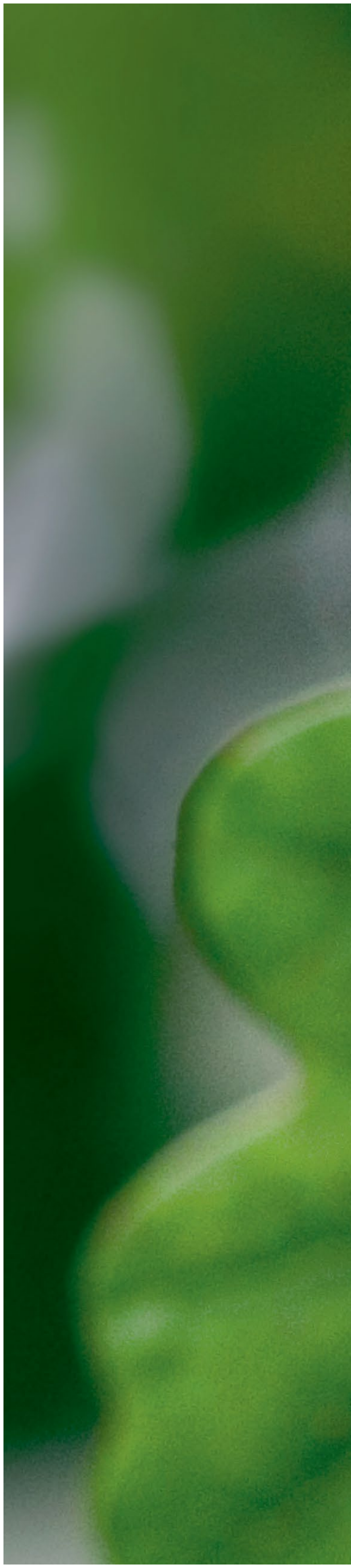
REIM entities can rely on different types of technology to help address the data management challenges for ESG reporting in the real estate sector.

There are targeted real estate solutions developed to collect ESG data at source, the majority of which are cloud-based software solutions used by asset operators. They rely on templates specifically designed to capture ESG data for the real estate sector, perform basic quality control functions and normalize the data based on a specified data model.

There are also solutions that address broader needs, such as portfolio monitoring tools offering specific modules for ESG data management. These assist with ESG data collection and reporting on the basis of standardized data sets and dashboards that can be customized as needed.

In addition to software solutions, we are also seeing asset servicers start to offer data management services dedicated to ESG metrics.

New technology solutions and data management services are still emerging, and the market is likely to develop and propose further innovative solutions and services in the coming years. This will go hand-in-hand with the changing ESG reporting landscape, as technology providers and asset servicers seize opportunities to answer a growing investors and Asset Manager' demand for comprehensive, accurate ESG reporting in the real estate investment sector



Article #6 – RE-thinking Due Diligence – ESG impact on M&A

In the context of mergers & acquisitions, ESG aspects introduce a new dimension of transaction risk for real estate players, from compliance risk to operational and reputational risk.

Companies should therefore adjust existing ESG due diligence approaches to industry needs and standards, establish appropriate KPIs, review targets and identify ESG red flags.

For targets with utilization phase assets, the focus is mainly on environmental KPIs (e.g. existence of environmental policy, compliance, renewable energy use).

Targets from the project development space may require additional checks on social and governance aspects (e.g. workers' health and safety, anti-money-laundering and anti-bribery policies).

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Shedding light on the increasing role of ESG in real estate M&A deals.

Evidence is mounting that business performance is impacted by environmental, social and governance factors and recent developments demonstrate that the speed at which those elements become material is increasing. Drivers of this accelerating change are, for example, increasing transparency based on improved data availability around environmental, social and governance (ESG) factors, society's changing expectations as public awareness of social and environmental challenges increases and growing influence of investors as they integrate ESG factors into the core due diligence process. Hence, ESG has found its way to the Mergers & Acquisitions (M&A) business. The real estate industry has been a particular focus of regulatory bodies, primarily as the sector contributes to 36% of EU CO_2 emissions[1]. ESG due diligences provide meaningful insights for investors prior to a transaction. This article sheds light on the general concept of ESG due diligences and its specifications and particularities with regards to the real estate sector.

Shareholders and stakeholders increasingly expect their companies' management to focus on sustainability and contribute to global environmental goals, to act socially responsible and to become more inclusive and diverse. In other words, issues such as human rights violations, environmental ruthlessness or other ethical infringements can have vast negative influence on business as the companies' actions are increasingly impacting on how their stakeholders interact with and what shareholders demand of them. Consequentially, in the context of transactions, ESG aspects constitute financial and reputational risks. Investors seek for more transparency before signing a deal to avoid potential pitfalls linked to ESG concerns. This growing awareness for ESG amongst investors gives rise to ESG due diligence which is evolving from a niche to a widely known term and required competence in the M&A business.

Especially for deals in the real estate industry, ESG due diligence enjoys increasing prominence as the sector faces being closely monitored by governmental bodies and prudential authorities over its environmental impact. The EU Action Plan on Sustainable Finance should not be left unmentioned, as the included EU Taxonomy defines the criteria for ecologically sustainable activities and investments, making the impact of the investors' business on the climate and other environmental criteria transparent.

ESG due diligence takes the EU Taxonomy as well as other national and international regulations into account. Vigilant due diligences highlight red flags and may optionally also assess risks and opportunities and future value creation potential (e.g. cost reductions through increased energy efficiency).

General concept of ESG due diligences

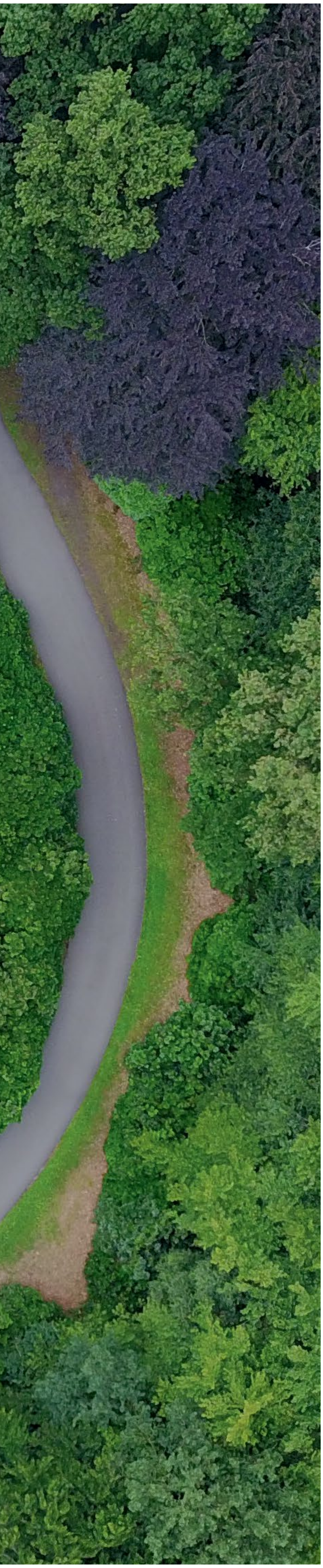
Generally, ESG due diligences analyze the compliance of the targets with national and international regulations as binding frameworks as well as non-codified stakeholder ESG-related norms and expectations. Further, it highlights the environmental, social, and governance status quo of a company.

With regards to the environmental dimension, a due diligence includes the existence of internal policies, responsibilities and management with regards to several environmental aspects (esp. energy, CO_2 emissions, materials, water usage and waste) summarizing the ecological impact of the business model as well as how it interacts with all key environmental stakeholders and works to mitigate its impacts.

The social dimension covers policies and responsibilities concerning social aspects, such as human rights, labor standards, health & safety, diversity and equal opportunities among others.

Finally, the governance dimension constitutes of analyzing the risk management systems, the existence of corporate codes of conduct (anti-bribery, anti-corruption, etc.) and the transparency of board and management decisions and remuneration.

It is of note that the approach to ESG due diligences is not a "one size fits all" approach for all industries. Each industry presents its own array of environmental impact and stakeholder interaction that must be considered. For example, a target in the chemical industry would have a particular emphasis on the environmental factors such as disposal of hazardous waste, whereas for a target in the textile industry the focus may lay on the social factors such as child labor or poverty wages. Hence, ESG criteria need to be selected from a bouquet of KPIs taking industry-specific and targetspecific factors into account.



KPIs for the real estate industry

For the real estate business with assets in the utilization phase, environmental topics outweigh social and governance KPIs as the industry's impact on the environment stands in the foreground. Due diligences hence may focus on environmental KPIs such as the existence of an environmental policy (and a responsible team), its compliance with national and international regulations, the usage of renewable energy and the existence of monitoring systems and regular disclosure of sustainability reports. Additional focus areas are the age of the buildings, the status of modernization and the recyclability of building materials.

For targets involved in real estate project development, the list of KPIs should be extended to measures of the environmental impact of the construction phase itself, as for example drilling machines are responsible for large parts of particulate matter and noise in urban areas. Moreover, social KPIs need to include workers' health and safety, such as the exposure to hazardous chemicals or events (floods, fire, etc.), the existence of emergency response plans, trainings, and compliance checks. Especially for the project development business, governance KPIs should include policies in place such as anti-bribery, anti-corruption, and anti-money-laundering.

As time is usually short for M&A decisions, the right selection of KPIs is crucial. Only an analysis of the appropriate measures provides the management and stakeholders with the information needed for making the right decisions. An insightful ESG due diligence hence requires methodological and industryspecific expertise.

Article #7 –
ESG as real estate value driver

Establishing a sound real estate ESG strategy is key for turning sustainability into a real estate value driver.

Effective risk management across the supply chain contributes to investment resilience (e.g. sustainable construction, building certification), opens up attractive financing conditions and improves financial market access.

Benefits include increased opportunities for growth (also in new markets), improved financials (more resilient balance sheets, stronger cash-flows), and strengthened stakeholder reputation. This in turn increases the chances to attract clients and talents.

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Recently, environmental and social issues have become a public and political priority, and as such, of material value for investors. An informed and regular approach to identification and management of ESG impacts shall protect investment portfolios and not only enhance resilience and guard against the risk of accelerated obsolescence and value erosion – and will also provide better financing conditions within a larger pool of new, more responsible capital, attracted to the industry to make a positive ESG impact.

In our previous ESG Real Estate Insights series, we have noted that the real estate sector, which generates approx. 36 percent of GHG emissions and consumes around 40 percent of the total power balance[1], greatly contributes to climate change. The high level of emissions is, among others, a result of using such energy-consuming materials as brick, concrete, steel, etc. However, in 2019 compared to the previous year, CO_2 emissions from the operation of buildings have increased to their highest level yet at around 10 Gt CO_2, or 28 percent of total global energy-related CO_2 emissions.[2] Emission reducing activities are incorporated in the European Green Deal, which goal is for the EU to achieve climate neutrality by 2050. The emergency of global mega-trends, understood as large-scale social, economic and environmental changes, should make the real estate sector change its approach towards a more sustainable development.

All of these brings us to the key question: What is the value of a sound real estate ESG strategy?

For the real estate sector, the EU Taxonomy drafted by the European Commission within its Sustainable Finance Action Plan (SFAP) is becoming the main guide for practitioners and investors to implement at sector and project level, when looking to ease their access to capital. The EU Taxonomy aims at three objectives when it comes to real estate projects: optimizing the use of resources, reducing emissions and waste, and extending the lifespan of assets by adopting a more circular economy approach that, in turn, will allow the subsequent elongation in projects' cashflows. To this end it is highly desirable to use innovative methods and technologies that effectively extend the life of buildings and/or their components. Finding solutions to extend the usability of objects, be it with new uses or by upgrading them to extend the current use, allows for greater economy for the investor – who should not always require major renovation or adaptation processes but rather implement an innovative approach. Circularity, considered from the phase of design, significantly improves the economics of a project by allowing the reutilisation of objects or their parts, recycling the resources used in its construction. It even reduces the impact that at the end of the life of an object needs to be considered – as these will incur taxes and costs associated to the demolition of objects, destruction of resources and remediation of the land as the urban and spatial development plans of cities encourage a more human approach to the use of land. Meeting the predicaments of the Triple Bottom Line approach, these solutions do generate economic benefits while reducing environmental and societal impacts.

The adoption of adequate property management practices is crucial in each aspect of its operation as ESG impacts directly depend on measures undertaken by investors, managers, tenants and ultimately even the users, each one at its level of involvement. Proper understanding of the value chain of the properties by all stakeholders will enable the development of effective strategies and drive sustainable change. Defining the ESG strategy with this knowledge will provide the management team with relevant insights to take action – and will also allow them to assess which initiatives will bring the greatest benefit to the entity's operations, i.e., to its shareholders and stakeholders together. Such benefits may include the following initiatives:

Increased effectiveness of risk management over climate changerelated risks

Risk management efficiency is an important matter affecting the value of real estate. At present, preventing climate change that may jeopardize financial stability is a key challenge and adapting to the already present changes is considered as important. The Task Force on Climaterelated Financial Disclosures (TCFD), created by The Financial Stability Board, has prepared a set of guidelines to help enterprises in the identification of climate change-related risks.

To this end, the early identification of climate change-related risks and the effective adoption of risk management policies and procedures do certainly have substantial benefits. Incorporating these aspects in the ESG vision enables a more favourable long-term strategy in line with the long-term approach in the EU Regulations on sustainable finance. To be able to achieve the objectives of the EU Green Deal, many regulations and directives are continuously being introduced by the authorities and the entities are obliged to know and align to these in order to develop longer-term strategies.

A way to build investment resilience

Tenants, users, investors and buyers represent a considerable power, as they expect not only high-standard buildings, compliant with contemporary market requirements, but also respecting local environmental issues, such as appropriate development of land, space for pedestrians, close proximity of greeneries or public transport. Modern and efficient buildings are attractive for clients and more probable to retain their value if managed in compliance with international standards. The approach affects the housing segment, too, contributing to the growing popularity of sustainable construction. Based on the PLGBC report[3], in 2019 the share of certified housing space increased by 14 percent compared to 2018. When considering all certified facilities in Central and Eastern Europe, Poland remains the certification leader with 51 percent of certified facilities located in the country.

The decision-making practice regarding supply chain and the selection and sourcing of materials remain a crucial aspect of ESG strategy development. The European Commission Construction Product Regulation[4] lays down harmonized conditions for the marketing of construction products and introduces the need to issue a Declaration of Performance for products (DoP), as well as a Voluntary Environmental Product Declaration (EPD). For example, in Poland, the Instytut Techniki Budowlanej (Building Research Institute) is responsible for the national EPD program for construction products. It has registered eleven manufacturers with active environmental declarations.[5] At the beginning of January 2021, around the world there were slightly more than 10,000 verified environmental product declarations, which denoted a 30 percent increase compared to the prior year. As far as building certification is concerned, the entire project and construction process is verified by an assessor, and then evaluated by the certifying body.[6]

Therefore, introducing these ecological solutions such as reduced water or power consumption, high acoustic comfort or ensuring access to daylight, shall decrease operating expenses and improve tenant satisfaction. Further, having considered future risks related to climate change and increased service prices, such measures will affect long-term sustainable performance of these investments.

Access to more affordable financing

To support and assist EU Member States in their transition to a green economy and to ease the adoption of new sustainable practices, the European Union is developing many instruments within the European

Green Deal Investment Plan[7] – the Sustainable Europe Investment Plan – such as the European Energy Efficiency Fund[8] and the Just Transition Fund[9]. The potential support from the EU will have to be accompanied by significant private investment. An opportunity to obtain more favourable terms of borrowing is another factor contributing to growing popularity of eco-investments. The number of banks and investors involved in "green finance" that are already offering better terms, larger credit facilities and further assistance to real estate players is growing steadily.

Entry to new markets and opportunities

Entities that follow sustainability guidelines may benefit from more strategic freedom, easier access to administrative permits and additional growth opportunities by creating new products and services or expanding their business activities in other regions or countries. This can create growth opportunities as well as ease the access to the new markets – leading to new revenue streams.

Meeting investors' needs

The growing interest of investors in ESG-related data has been observed. Recent environmental and social issues have become a public and political priority, and as such, a material value for investors. According to a 2020 research by GRESB[10], the share of investors who pay attention to this aspect has grown by 22 percent, which demonstrates that ESG standards will increasingly affect the valuation of real estate, resulting in greater differentiation in performance prospects between assets with well-aligned ESG credentials and assets which fall short in the eyes of investors and are therefore subject to weaker resilience and value erosion risks.

There are valuable outcomes generated by a robust ESG strategy: more resilient balance sheets, stronger cashflows with longer repayment terms, risk management systems adapted to the new environmental conditions are already developed for the industry, etc. Increasingly additional gains are evident for conscious investors as they manage better the new risks, access new capital with better conditions and profit from better reputation among their stakeholders which, in turn, increases their goodwill and the chances to attract and retain clients and talent. Time will tell on how successful these efforts towards the "greater good" were to provide viable, measurable and long-lasting value for the real estate industry as a whole.

Article #8 –
ESG criteria in real estate

While the environmental aspect of real estate is particularly prominent, it is crucial for industry players not to neglect the social and governance aspects in order to embrace a holistic ESG strategy.

Relevant governance factors include compliance with regulations, adequate and transparent remuneration, disclosure, anti-corruption initiatives, fostering diversity in management, organizational values.

External social aspects include the rehabilitation of public spaces, affordable housing, security in buildings, human rights.

Internal social aspects should also be addressed, e.g. workplace safety, labor practice standards, responsible marketing, and diversity. A corporate culture of ethics, compliance, and integrity is necessary to create a positive long-term impact.

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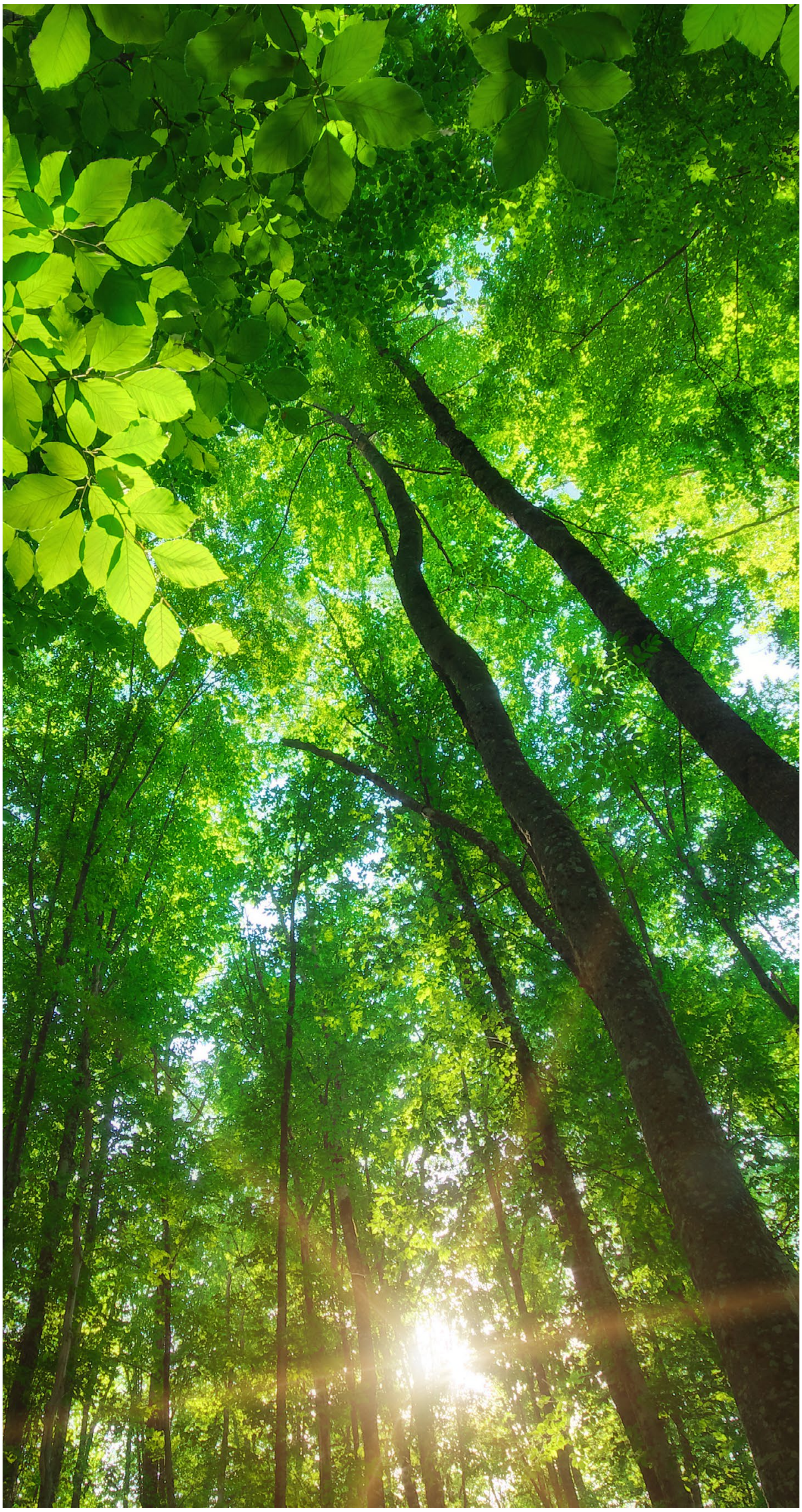
Do not forget "S" and "G" – a holistic approach to ESG is required.

Environmental, social, and governance (ESG) considerations have become increasingly important across the real estate sector. Yet, awareness regarding the three ESG aspects seems to differ across "E", "S", and "G". Since buildings are considered as one of the key factors in climate protection, unsurprisingly, there is often greater emphasis on the "E". Social as well as governance elements tend to receive less attention in the public debate. However, it turns out that both "S" and "G" are also of particular relevance for real estate companies.



Real estate companies consider "S" and "G" as crucial

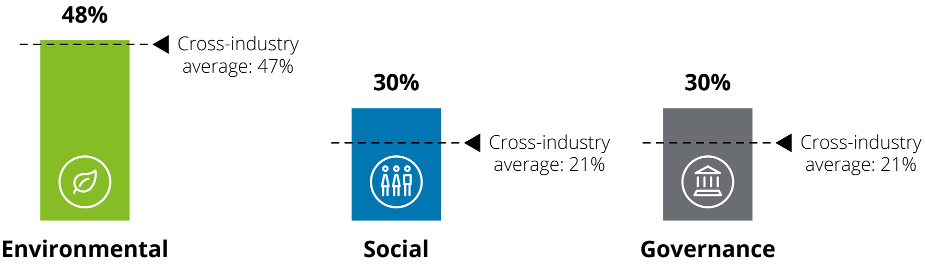
Undoubtedly, ESG is increasingly turning into an important impact factor in the real estate industry. According to the 2020 spring edition of Deloitte's European CFO Survey, most companies already incorporate ESG criteria into their business strategy. About half of the 114 CFOs surveyed from the financial services and real estate industry – a share well above the cross-industry average – stated that even all three of the following aspects apply to their company (see fig. 1).

Concerning funding opportunities, the aforementioned CFO Survey points out that a better disclosure of environmental issues is perceived as the most promising aspect to enable companies a better access to the capital market. Nevertheless, 30% of financial services and real estate companies – 9% more than the crossindustry average – also consider social and governance elements as crucial (see fig. 2).

Fig. 1 – Share of CFOs reporting that all of the three given ESG considerations apply to their company

Source: European CFO Survey Spring 2020 – only financial services and real estate companies.

Fig.2 – Share of CFOs reporting in which aspect of ESG they see disclosure improvements as an opportunity for their company to gain better access to capital markets



Source: European CFO Survey Spring 2020 – only financial services and real estate companies.

The observed differences across "E", "S" and "G" are not as pronounced as one might assume given the public debate about ESG issues. So, aside from fostering eco-friendly buildings, increasing the amount of green space or using environmentally compatible energy sources, there are also several critical social and governance impacts in the real estate sector.

Governance factors in real estate

Regarding the "G" in ESG, governance scrutiny is central to companies' ability to continue business operations. While promoting corporate governance can present an opportunity for real estate companies in order to drive long-term value, not addressing governance considerations carries high risks – reaching from penalties and fines to a loss of reputation and market penetration.

Governance elements include, among others, compliance with governance rules and guidelines, ensuring adequate and transparent remuneration, promoting transparent disclosure of governance issues, taking action against corruption, fostering diversity in management and governing bodies, as well as establishing and communicating organizational values. A corporate culture of ethics, compliance, and integrity is the foundation to create a positive long-term impact.

Social factors in real estate

Recently, the "S" in ESG has received growing attention as the COVID-19 pandemic put greater emphasis on the social factor. Since real estate companies have a significant social impact, they should consider the "S" as a value driver.

Social aspects in real estate include, for example, participation in the rehabilitation of public spaces, affordable housing, social housing or care centers as well as ensuring security in buildings and assuring human rights. From an internal perspective, social elements may also comprise ensuring workplace safety, fostering high standards in labor practices, responsible marketing, and promoting diversity across the company.

Incorporating social considerations can increase companies' ability to attract talent – especially among millennials. The risk of neglecting social elements can lead to a lack of reputation, lost work, higher employee turnover, increased operating costs, and may threaten the ability to operate.

Implications for real estate companies

Although environmental issues are of particular importance in the real estate sector, ESG goes beyond an isolated consideration of "E". As described above, the role of social and governance elements should not be underestimated, and low awareness regarding "S" and "G" elements may result in high risks – not only penalties and fines, but also loss of reputation and market penetration. Real estate companies need to adapt to changing investor, consumer and commercial expectations – ensuring the acceptance of their business practices and operating procedures by its stakeholders and the public. A holistic approach to ESG is required in order to establish a successful "ESG-proof" business. This can lead to a greater ability to attract talent, enable reputation gains, and may ensure the social license to operate.

Article #9 –
Green Leases – In the ESG context

In addition to green building certificates (LEED, DGNB, BREEAM), green lease agreements are likely to play a bigger role for many real estate actors and to become market standard at some point.

Green lease agreements specify in particular how environmental objectives will be met (climate change mitigation and adaptation, circular economy etc.).

Typical arrangements might incorporate clauses concerning construction, fit-out and maintenance, as well as use, supply and management of buildings, and regulations for data exchange.

Both building owners and tenants should analyze the specific need for sustainable clauses.

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Industry standard for the future?

In the institutional real estate market, green buildings and certificates for green buildings, such as LEED, DGNB, BREEAM, ÖGNI, are already market standard. Due to the already visible impact of the climate change and the ESG regulations enacted by the EU Commission, also the green operation of a building and green leases gain increasing importance. This raises the question of what specific provision can be regulated in such "green leases".

In December 2019, the EU Commission introduced the "Green Deal". Based thereon the EU Commission adopted three eminent regulations[1] that form the framework for the implementation of environmental, social and governance (ESG) criteria. One of those regulations is the Taxonomy Regulation that provides that only those economic activities are "green" which significantly contribute to the achievement of environmental objectives. The relevant six environmental objectives are:

1. Climate change mitigation
2. Climate change adaptation
3. The sustainable use and protection of water and marine resources
4. The transition to a circular economy
5. Pollution prevention and control
6. The protection and restoration of biodiversity and ecosystems

Also driven by these environmental objectives, green lease agreements gain major importance for financial market participants (thus, also banks and institutional investors), and companies of public interest, i.e. large, listed real estate companies (with more than 500 employees on an average during a financial year)[2], for whom the Taxonomy Regulation mandatorily applies. Green lease agreements are not only relevant for financial market participants that own or rent such properties, but also for financial institutions that finance real estate properties.

According to a research by Savills Investment Management[3], 73 per cent of institutional investors expect green lease clauses being universally incorporated between tenants and real estate investment managers by 2029.

For several reasons, green leases are not only relevant for financial market participants and large, listed real estate companies, but also for other property owners. Such reasons are, for example:

i. They expect a higher purchase price when selling the property, or more favorable financing conditions when financing a property

ii. They intend to develop the property with the purpose to later transfer it to an institutional investor, where not only real estate certifications (such as LEED, DGNB, BREEAM, or in Austria ÖGNI) are important, but also green leases will play a major role

iii. They expect higher letting rates, or higher rents when letting premises, as modern, sustainable buildings often attract tenants of a higher income class

iv. They voluntarily want to comply with ESG objectives

v. They expect that the scope of applicability of the Taxonomy directive will be extended also to further property owners

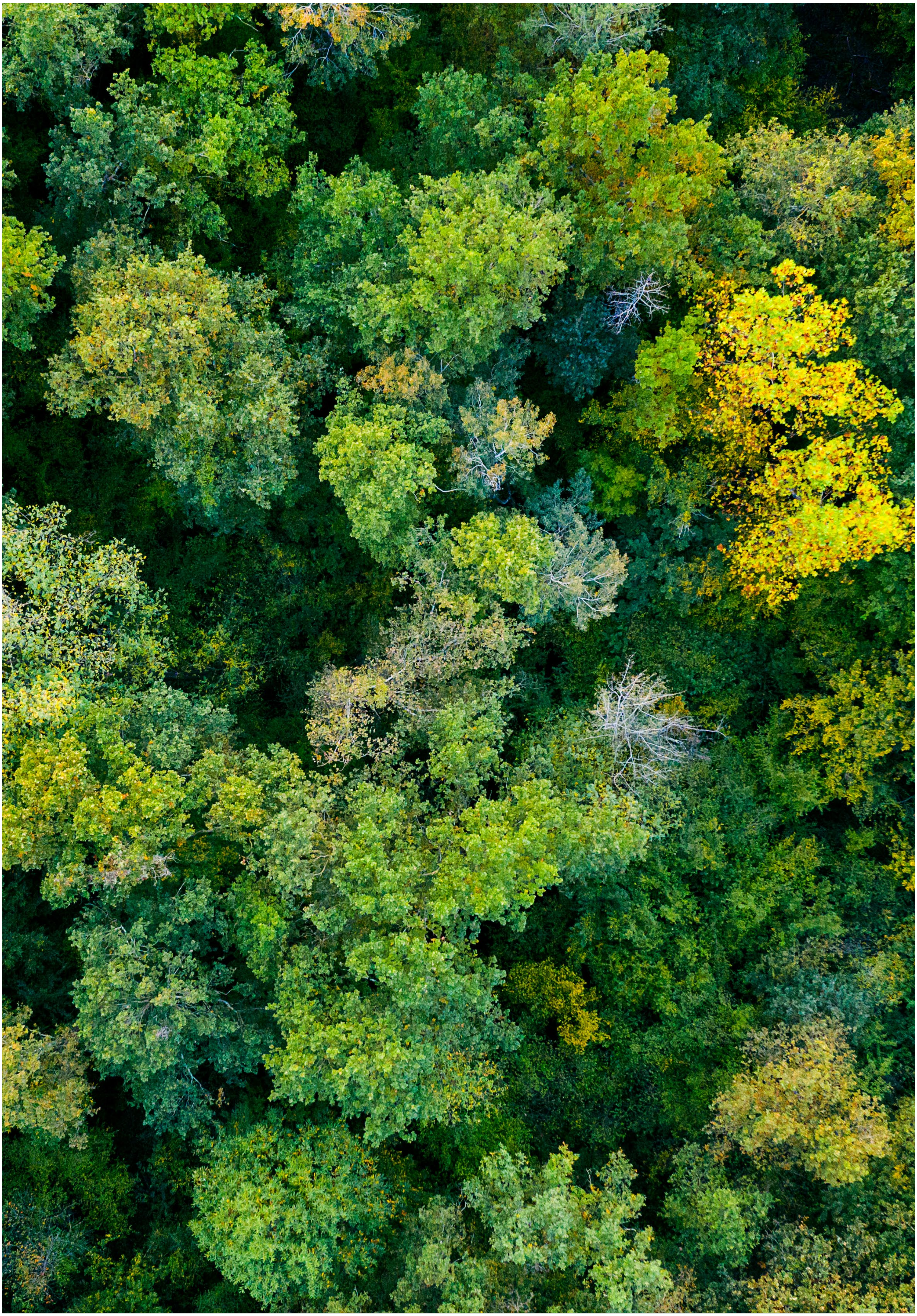
vi. They will have to comply with the taxonomy objective if they want to establish or maintain business relationship with such financial market participants and companies of public interest.

Thus, it is to be expected that "green leases" will be market standard in the near future.

What is the content of such green leases?

Green leases are lease agreements that aim to ensure the sustainable construction/fit-out, usage and maintenance of the property.

In several countries, such as the Anglo-Saxon countries, Sweden, the Netherlands, or France uniform standards that could serve as a reference framework for green leases do already exist. Also in Germany, Zentraler Immobilien Ausschuss e.V. (ZIA) has published a compilation of sustainable clauses under lease agreements.[4] There is, however, no common European standard, or definition of a "green lease".



Which clauses might be relevant for a property will to a certain extent depend on the purpose of the lease and the circumstances of each individual case. When drafting a lease agreement, these circumstances will have to be carefully assessed.

The most important clauses that might be incorporated in green lease agreements are, for example, the following:

Use, supply and management of the property

Lease agreements might provide for a right of the landlord to supply the building (predominantly) with sustainable energy, such as power, heating, cooling, and to use only sustainable cleaning products. It is very important to regulate this right in the lease agreement, as the cost for such sustainable products and supply might be higher than non-sustainable products, and to specifically regulate that the landlord may charge on to the tenants respective higher cost. Otherwise, the landlord runs the risk that these cost may be challenged by the tenants under the service charge reconciliations.

In addition, an obligation, or at least a best effort commitment of the tenants may be incorporated into the lease agreement to also purchase sustainable energy, such as power, or cleaning products.

Leases might provide for an obligation, or best effort commitment of the tenant to (i) separate waste collection to the extent possible, or to (ii) use to the extent possible recyclable products. In order to achieve this goal, it might also be beneficial if the building already provides for facilities for such separate waste collection.

Moreover, regular sustainability workshops between landlord and tenant, and sustainability guidelines for the property might be useful in order to maintain, or improve the sustainability efforts for both, landlords and tenants.

Construction, fit-out and maintenance

Of course, already prior to and during construction of a property, the property owner can foresee a lot in order to facilitate a sustainable use of the property by the tenants: The building might already provide for sustainable heat or cooling facilities, for waste disposal areas that allow separate waste collection facilities to the extent possible.

There might, e.g., be storage rooms for bikes and e-bikes, or car parking areas with e-supply facilities. In respect of core-and-shell lease agreements, there might be an obligation/best effort commitment of the tenant to equip or fit-out the premises with sustainable products only.

Beyond that leases might provide for an obligation/best effort commitment of the parties to perform maintenance works with sustainable products, and to consider contractors that adhere to certain sustainability standards.

Moreover, it would also be possible that the landlord and the tenant develop a sustainable use concept for these premises.

Transparency, data exchange, monitoring

Important are also clauses according to which the parties are obliged to exchange data and information, especially regarding energy supply, water supply and waste disposal, or data for the determination of the CO_2 balance of the leased premises.

Moreover, the leases might provide for an obligation to implement monitoring concepts.

Other individual regulations

Depending on the individual situation, there might be other regulations that could be considered in the lease agreements.

How to ensure the enforcement of such clauses?

Thus far, green lease agreements are according to our experience not yet that common. Nonetheless, due to the growing importance of ESG criteria, we expect that "green clauses" will also be implemented into lease agreements in the near future. As already mentioned above, lease agreements might contain obligations by the parties, or merely best effort commitments. Especially such best effort commitments are, however, difficult to enforce.

With respect of important sustainability clauses, penalties, or monetary incentives could be provided in the lease agreement. However, also national mandatory tenant protective legal provisions or court decisions might be relevant to consider. Under mandatory national tenancy acts it might, e.g., be uncertain whether higher operating cost due to higher prices for green power, or green cleaning equipment, may validly be shifted to the tenants. In this respect, clarification by the governmental authorities might be beneficial, where required.

Summarizing, as green leases will play a major role in the future, building owners and tenants should analyze the specific need for sustainable clauses, and consider the implementation of such green clauses into their lease agreements. This might have benefits during the use of the building, but also with respect of financing or intended sale of the property.

Article #10 –
Decarbonization of real estate

In the light of new EU goals and regulations, real estate companies need to consider decarbonization strategies that cover the entire life cycle of assets.

It is essential to address both operational and embodied carbon footprints.

Companies should embrace a holistic strategy of decarbonization, energy optimization, and circular economy that covers all lifecycle phases, including design, construction, use phase, renovation, and demolition.

An emissions reporting and reduction commitment of industry leaders would be desirable, ideally in accordance with standards and tools such as Science Based Targets, Carbon Disclosure Project, Net Zero Carbon Building Commitment, the GRESB initiative etc.

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It's time for action

Energy use in buildings for lighting, heating or cooling leads to direct or indirect CO_2 emissions. Building materials also carry embodied carbon resulting from their mining, processing, manufacturing, transportation and installation. With carbon embedded in nearly every phase of building construction and operation companies have to start with their decarbonization program to be able to contribute to Europe's ambitious goal of 2050 climate neutrality efforts.

To understand the decarbonization of real estate in further detail, it is important to shed light on the elements of decarbonization in each phase of the real estate life and consider the essentials of a decarbonization strategy and its specifications.

Decarbonization of real estate

Currently, roughly 75% of buildings in the EU are not energy efficient, yet 85–95% of today's buildings will still be in use in 2050.[1] Thus improving energy efficiency in existing buildings plays a key role in achieving the carbon-neutrality by 2050. The other key part concerns the construction of new buildings.

If we consider the whole life cycle of a building (approximately 50 years) there are different phases on which companies from the building sector (construction and real estate) must have an influence: design, construction, usage, renovation and demolition.

Furthermore, there are two types of buildings' carbon footprint: operational and embodied. The operational carbon footprint is defined as the amount of greenhouse gases directly generated as a result of building operations. The embodied carbon footprint is associated with the production of building materials and products, transport, and construction processes.

Throughout the life cycle of each building, good practices addressing operational and embodied carbon footprint already exist and are progressively becoming standard.

Design and Construction

Carbon efficiency results are significantly related to decisions taken at the design stage. Therefore, under the Energy Performance of Buildings Directive[2] from 31 December 2020 new buildings must be constructed to a nearly zero energy standard (NZEB). Minimum energy performance requirements must be set by EU countries in their national plans. For example, a new residential building in Poland should have a PE[3] indicator not higher than 70 kWh/m^2/year, reduction from 95 kWh/m2/year.

In France the new construction regulation (RE2020) not only targets the energy performance (-30% compared to the previous regulation RT2012), but also sets objectives in terms of kg CO_2/m^2/year and in terms of percentage of renewable energies. This policy aims to get out of fossil related energies on the one hand and reduce the energy independence of the country on the other hand.

To aim sobriety in energy, setting rules on carbon at the design and construction planning stages is key for all European countries and designers and project planners have multiple options on the table:

- Increase the proportion of bio-based materials (wood, clay, wool and even straw) usually available locally.
- Pay attention to more mainstream materials carbon footprint.
- Think in terms of "Cradle to Cradle" (C2C), using modular techniques, which can reduce up to 40% of the environmental footprint and/or foreseeing the deconstruction phase.
- Lean on BIM technology for more efficiency, and form "material banks for the future" (what material will be available when a building will be deconstructed in 50+ years?).
- Produce energy on site (solar panels, heat pumps, heat networks, etc.)

Project owners are already translating these objectives in their specifications pushed by national and European regulations such as the European taxonomy. This will only reinforce an already strong demand of green assets from investors. Therefore, this is key in terms of differentiation from competitors.

Usage

Decarbonization of buildings focuses mainly on net zero-emission in terms of facility use. Regarding existing buildings, this status can be achieved through major renovation, renewable sources of energy, "green energy" purchasing, efficient management systems and transition to non-carbon heating and cooling sources. However, carbon efficiency results are significantly related to decision taken at the design and planning stage. But there are numerous things that can be done besides of these phases.

First, considering life cycle perspective, a major issue is to use the facility for as long as possible, assuming good energy efficiency status. Sometimes, a good solution is to find another use for existing buildings without major renovations and adaptations. This reduces the carbon footprint of the construction and reconstruction process.

Second, increase the intensity of the building's usage. Indeed, many buildings have only one function (i.e., offices or housing), therefore, they are only partially used during the day and night. Considering that the coatings of buildings are significantly improving, transferring heat or cold trough smart ventilation systems from office to housing at night could generate vast energy savings.

Third, one of the most rapidly developing branches of technology is the Internet of Things (IoT). It has the potential to reduce the cost of consumed energy by controlling the lighting and temperature of rooms that are currently not occupied. The system allows to control the basic functions of the building from the mobile phone or tablet from anywhere. The central units can be adapted to the occupiers' needs, so that when they are outside the property, unnecessary installations are switched off and before arrival the building is being prepared again. However, the owners are the key link in the decarbonization process. They are the ones who make most of the decisions related to the design of the building as well as its subsequent use. That is why raising their skills in managing their properties and the knowledge and awareness of decarbonization are so important.

Renovation

"Only 1% of buildings undergo energyefficient renovation every year, so effective action is crucial to making Europe carbon-neutral by 2050". These words extracted from the renovation wave webpage[4] of the EU describe the magnitude of the task. To achieve its intermediary goal of 55% emission reduction by 2030, the EU should reduce buildings' greenhouse gas emissions by 60%, their final energy consumption by 14% and energy consumption for heating and cooling by 18%[5]. But, at this stage in Europe, there are no mandatory minimum energy performance standards for existing buildings yet. And filling this lack is a key challenge to reach the EU goals. Targeting a maximum of 80 kWh/m2/year[6] is considered by some experts as the only way to achieve carbon neutrality by 2050.

If owners don't take into consideration the wholeness of each energy savings deposit at the beginning of renovation project (e.g., addressing simultaneously roofing and attic, ventilation, windows, heating and hot water, walls, floors, and airtightness) many problems can arise. For example:

- New pathologies can appear in the building when windows are replaced from simple glazing to triple. If the ventilation is not rethought simultaneously, mold can appear if the air flow is insufficient.
- If the heating system is replaced before the coating is improved by insulation, the sizing of the system could be inadequate, thus generating performance issues and an accelerated aging of the system.

This list of examples could go on, and in addition to that, the cost of a renovation in many steps is incredibly higher than the cost of a single intervention when the target of consumption is the same.

Furthermore, some countries already have an obligation of renovation in their legal texts. French policy on tertiary building imposes a reduction of respectively 40, 50 and 60% of energy consumption by 2030, 2040, and 2050[7]. Another text yet to be implemented in the French regulation will forbid owners from renting residential properties starting from 2025 if their Energy Performance Certificate grade is G.

Public Policies of other countries are already or will soon be taking these goals into consideration as they translate the will of the EU in their respective regulations. In the meantime, asset managers should start preparations for a complete and efficient renovation strategy.

Demolition

The Waste Framework Directive of the EU aimed to have 70% of construction and demolition waste recycled by 2020. However, only about 50% of C&D waste is currently being recycled[8]. Nevertheless, some EU countries have already developed and implemented a framework which leads to a recycling rate of up to 90%. Indeed, there are many good practices in Europe and beyond to learn from.

By the end of 2024, the Commission will review the material recovery targets set in EU legislation for construction and demolition waste. The Commission will put in place measures to increase reuse and recycling platforms and support a well-functioning internal market for secondary raw materials. Moreover, the EU taxonomy already imposes a demanding framework for the companies who want to label their construction and renovation activities as "green"[9].

Once again, as soon the countries implement the European directives into their laws, the market starts a growth phase. And thus, multiple actors are starting to coordinate their efforts on the reuse and recycling market. If the lack of compliance with these new regulations not always results in compelling fines, some local urbanistic authorization like a demolition permit for example might and probably will require an inventory of all the materials that can be reused or recycled in the short term.

Furthermore, these recycled or reused materials are considered as carbon neutral in some regulations[10]. This is decisive when the Life Cycle Analysis of the building is mandatory. The other argument of such materials is also the cost. If building materials continue their inflation, whereas in the meantime, the recycled materials continue economies of scale, soon their price charts will cross each other.

For all these reasons, construction and real estate companies, as well as asset managers companies have to invest now in these markets first to be compliant with the existing regulations and those to come; and second to detect early opportunities that will satisfy their investors and clients and create a market differentiation factor.

Decarbonization strategy and management

As outlined previously, operational and embodied carbon footprints are the two types of carbon footprint in a building. The operational part is directly generated by all building operations. The embodied part is associated with the production of building materials and products, transport, and construction processes. Good practice in this area should be based on circular economy principles. That emphasizes the importance of decisions taken at the design and planning stage, which affect both new and existing buildings.

The European Commission has confirmed that reducing greenhouse gas emissions by at least 55% by 2030[11] compared to 1990 is a realistic course of action that will contribute to achieving climate neutrality by 2050. To achieve this goal, more rapid reductions in the building sector will be required. For example, Germany's official interim target to reduce carbon emission from building has been set at 70 million tons of CO_2 by 2030 (currently it is 120 million tons)[12]. This results in an annual reduction of 5 million tons of carbon dioxide per year, which is more than double of the current reduction. This requires action on building energy policies, technology choices and energy efficient measures.

Proper building management and facilitate maintenance is an important activity during the operational life of a building, because at this stage it is possible to offset lifetime greenhouse gas emissions. Recommended actions in this area are the adoption of energy performance tools, systems and standards enabling evaluation, monitoring and energy management. Investors need to understand how the identification and assessment of climate-related risks is integrated into existing risk management processes. Regulatory and emerging requirements (e.g. emission limits) as well as other relevant factors related to climate change should be taken into account, among them:

- The TCFD guidelines[13] aiming at need for disclosure what could be the financial exposures related to greenhouse gas (GHG) emissions associated mainly with energy consumption, and other climate risks e.g. water scarcity and vulnerability to extreme weather events.
- Need for measurement of key business indicators and forecasting future trends – related to climate and energy factors, helps to detect risks of significant costs or constraints to a given service capacity.

Thus, a commitment by industry leaders to report and reduce emissions should be made in accordance with international standards and tools, such as Science Based Targets[14], Carbon Disclosure Project[15] or Net Zero Carbon Building.

Commitment[16], the GRESB initiative[17], the CRREM tool[18], or the ACT initiative[19] and GHG Protocol.

Investing in new technologies is essential to managing transition risk as well. Changes in demand and the subsidy of regulatory measures to sustainable investments significantly affect investors earning potential and appropriate risk management. Producers and suppliers of building materials are also responsible for the size of the embodied carbon footprint[20]. They should strive to maximize the use of renewable energy sources in production and transport and to adapt their business models to the principles of a circular economy. Communication on climate change, which involves educating, informing, warning, mobilizing or inspiring, is another issue that needs to be significantly emphasized. Proper stakeholder identification, active management and communication can define project success and contribute to rapid emergence of new solutions.

Strategy recommendations
Make no mistake, the race has already started. EU has set new rules and will continue to reinforce them. Real estate industry should adapt business to the following rules as an expected approach to fulfill multiple sustainable objectives:

- Be compliant with regulations (European, national, and even local).

- Detect early on new opportunities to control the cost of building operations and to stay one step ahead of your competitors.

- Attract investors whose appetite for green assets is far from being satiated.

- Reinforce your employer brand to maintain your attraction towards new talents.

Apart from these business centered incentives, we also believe that when companies are able to tackle the carbon neutrality objective, they have the obligation to act. Yes, this is a race, but it is not as much a race between competitors, it is a race against time.

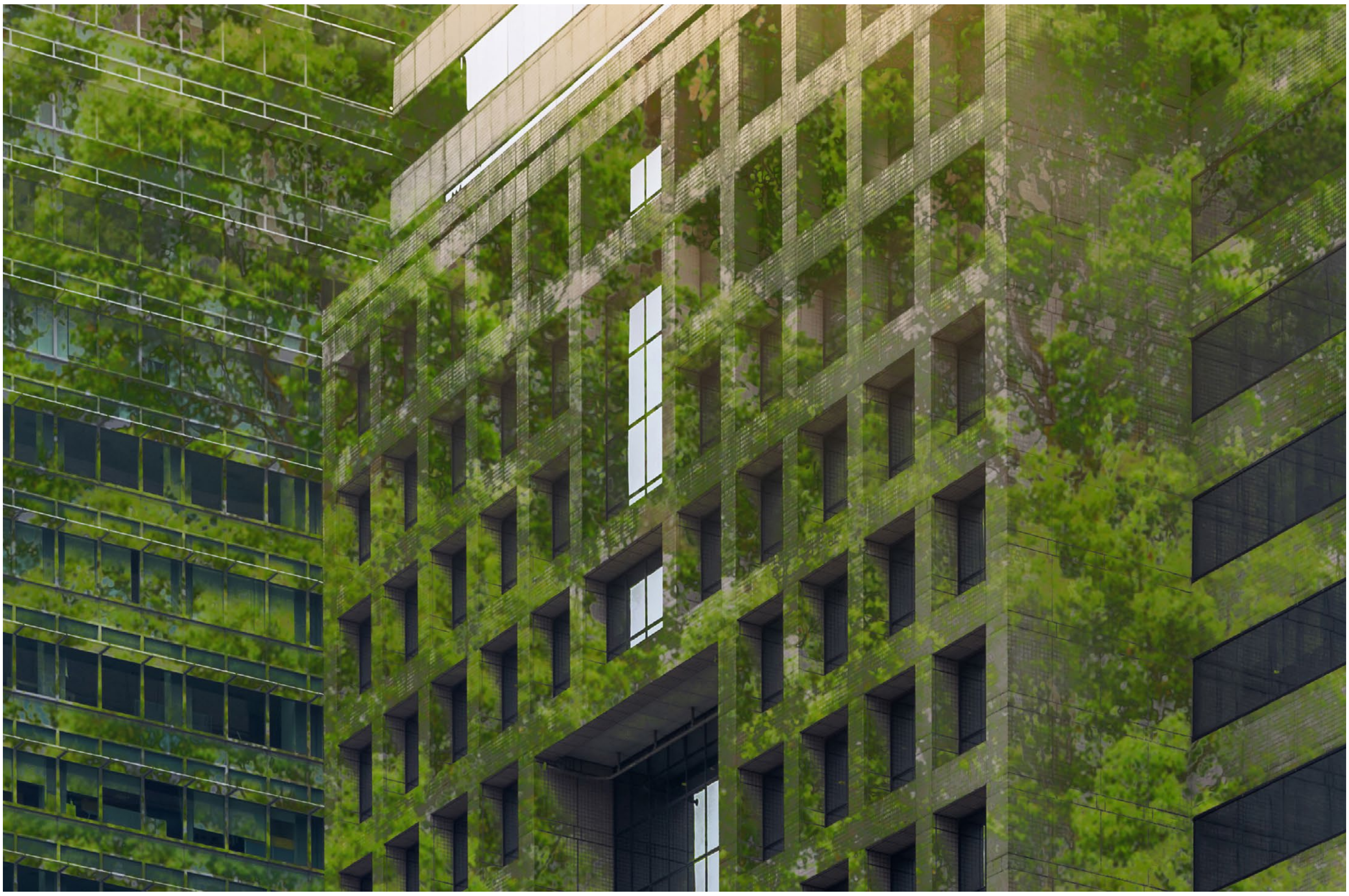
Based on current experience in cooperation with clients across a range of sectors including the construction and real estate industries, it is evident that defining both the level of decarbonization ambition as well as specific decarbonization targets and roadmaps is a key activity within the broader business and strategic context of corporate development and transformation. The level of accepted climate ambition and the expected speed of decarbonization will impact the level of costs as well as the level of opportunities and risks, market and reputation for the real estate companies. An entity's strategic approach will have major impact on future business.

Many entities are at a "crossroads", because they must make strategic decisions in the face of uncertainty and consider (on a risk-reward basis) which side they will decide to focus on – e.g. attaining gains or mitigating risks connected with climate transformation and physical risks.

There are two major basic climate scenarios driving targets and decarbonization initiatives. An entity may choose the "compliance path" – plan minimum effort to be aligned with national neutrality plans and other regulatory obligations to line up with the level of ambition of European Net Zero 2050. Alternatively, companies will drive to be among the "leader's ambitions" who are moving faster toward climate neutrality, valuing the market and reputational opportunities arising from the common good of limiting climate change more highly than the risks associated with the technological and cost constraints of the transition.

ESG benefits all real estate stakeholders

As the expert contributions in this report have argued in great detail, ESG aspects pose many intricate challenges to the real estate sector. It is by no means a trivial undertaking to devise and implement industry-specific ESG strategies, to collect data and manage assets accordingly, to ensure regulatory compliance and thrive on the market – all at the same time. Yet while implementing their ESG initiatives, industry leaders should decidedly keep the bigger picture in mind and realize the inherent value proposition of any ESG transformation. And that value is significant. In spite of the initial hurdles, specific cost and efforts involved, ESG initiatives not only generate a broad range of benefits for the real estate sector itself, but also for all other stakeholders such as investors, customers and overall society. This aspect is of fundamental importance, as it is society at large that awards an implicit social license to operate to organizations. Real estate players need to build for future growth now by securing that extremely valuable asset for the long term. Now it's time for action!



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Article #10 – Decarbonization of real estate

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