Building performance standards as a catalyst for investment

Policymakers around the globe are implementing building performance standards (BPS) that often require buildings to achieve specific performance targets for energy consumption and greenhouse gas emission reductions over their lifespan. Navigating an array of BPS across jurisdictions can present challenges and also opportunities to accelerate investments that promote energy savings, reduce emissions and maximize long-term returns.

As buildings account for nearly 30% of global energy consumption and their operations account for nearly 30% of global carbon emissions, regulators worldwide are intensifying their efforts to reduce these impacts through BPS.[1] Given the aging building stock and a heightened focus on the built environment in addressing climate change, the majority of BPS are becoming more stringent, with significant penalties for non-compliance.[2] The shift is prompting many real estate investors to re-evaluate the resilience of their portfolios.

By April 2024, 14 US state and local governments have enacted BPS, all of which either have or contemplate fines and penalties for exceeding prescribed thresholds.[3] Similarly, the EU's revised Energy Performance of Building Directive mandates substantial renovations and aims for a fully decarbonized building stock by 2050.[4]

Given the varied definitions, metrics, targets, and financial implications across jurisdictions, owners with extensive property portfolios likely face a complex challenge. Here's what owners[5] can do to navigate this complexity:

1. **Perform a regulatory scan**
   While there is some commonality among BPS, each jurisdiction may prescribe its own timeline for compliance. After setting a baseline, establish a monitoring process for changes that could impact exposure.

2. **Identify fine and penalty methodologies and forecast exposure based on current and future state**
   Each jurisdiction has its own definitions and methodologies for measuring energy and carbon reduction goals within their BPS. Fines and penalties under BPS typically depend on a few key data points, including energy consumption, building type, age and size. Incomplete or inaccurate data could result in miscalculated risk. Many BPS methodologies mandate progressive reductions in emissions limits and energy use. In addition, the energy demand by building occupants can change over time. For example, the energy use of a building could vary significantly if occupants switch from using standard computers to high-processing power computers.

While certain jurisdictions may seem unlikely to mandate BPS, the focus on climate has resulted in many fast-moving changes; being agile to understand and adapt to climate transition risk scenarios, such as those presented by BPS, is a market advantage. It may be important to employ dynamic modeling capabilities that can adapt to these changing circumstances.

3. As applicable, evaluate lease provisions for impact
As a lessor or lessee, exposure may vary based on the specific provisions of the lease agreement. While most BPS target building owners, fines and penalties may be passed to tenants through lease agreements. While owners may find their risk mitigated during a lease period that enables pass-through, retaining and attracting new tenants with similar provisions may become increasingly difficult.

4. Assess intervention strategies for actual or expected noncompliance
Many of the interventions that may be necessary to avoid fines and penalties could be capital intensive. Costs could be lessened through the pursuit of tax strategies, technologies such as smart buildings and digital twins, and co-investment cooperation between owners and tenants.

5. Leverage compliance for marketplace differentiation
As tenants increasingly seek energy-efficient buildings for cost savings and/or to meet their own climate-related goals, owners may assess if compliance with BPS enables them to command a premium for this differentiated performance. In addition, those seeking to make investments in real estate, modeling potential exposure to BPS can inform capital allocation decisions to more resilient buildings.

Despite the potential challenges of a localized and expanding BPS landscape, these regulations can serve as a significant driver for long-term investment in building performance. Long-term plans with a lifecycle lens that consider the entire asset portfolio are important in achieving compliance with BPS, decarbonization goals and higher returns on investments.

Contacts

Lauren Pesa
US Real Estate Sustainability Leader
Deloitte & Touche LLP
lpesa@deloitte.com

Nate Florio
Real Estate Financial Advisory & Modeling Leader
Deloitte Transactions and Business Analytics LLP
naflorio@deloitte.com

Ya Yu
Audit & Assurance Senior Manager, Accounting and Reporting Advisory Services
Deloitte & Touche LLP
yayu6@deloitte.com

End notes:

1. "2022 Global Status Report for Buildings and Construction: Chapter 3.3 Emissions in the buildings sector". United Nations Environment Programme. November 2022.
2. "To create net-zero cities, we need to look hard at our older buildings". World Economic Forum. November 2022.
3. "Comparison of U.S. Building Performance Standards". Institute for Market Transformation. Last updated April 2024.
4. "Directive - EU - 2024/1275 - EN - EUR-Lex". The European Union. Last accessed June 2024.
5. While these steps have been articulated from the perspective of the owner, the same steps may be relevant for a current or prospective lessee or lender in a building.