ESG DOMINATES THE NEW INVESTMENT CYCLE

Together with clients increased preferences for sustainable assets, European and national legislators are expected to further tighten the existing legislation regarding economic activities alignment with ESG factors.

The new EU taxonomy is expected to play an important role in helping the EU scale up sustainable investment, which is vital to meet the EU's climate and energy targets for 2030 through 55% emissions reduction and reach the objectives of the European Green Deal.

It aims to provide companies, investors, and policymakers with appropriate definitions for which economic activities can be considered environmentally sustainable. In this way, it creates security for investors, protects private investors from greenwashing, helps companies to become more climate-friendly, mitigates market fragmentation and helps shift investments where they are most needed.

In fact, the EU taxonomy has already brought significant benefits to some industries, for example, in banking: banks generally consider the taxonomy as a positive initiative to foster and advance sustainable finance because of the consistency and greater transparency it brings into the industry. Also, most of the institutions believe that common definitions will improve their approach to managing all aspects of environmental, social and governance (ESG), including the way to interact with customers.

Read here the opinion of some of the experts consulted by Iberian Property, regarding the following question:

«What is the impact of the new EU Taxonomy for real estate financing?»

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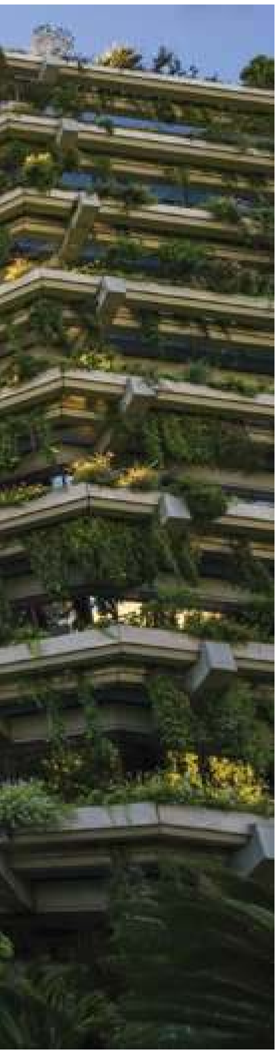

To date there have been market tools as certifications, appraisals, ratings and best practices that have been used in the real estate industry to evaluate and certify the level of compliance with ESG criteria.

With the implementation of the general regulatory framework through the publication of the Directives and Regulations forming the basis for, and drawing up, the EU Taxonomy, although the new Energy Performance of Buildings Directive has not yet been approved, it is already possible to conclude that the regulation will provide transparency and bring about a structural impact on real estate financing.

The main objective is the decarbonisation of the real estate sector, which is the main producer of greenhouse gas emissions, together with the transport industry. Financing entities will undoubtedly act as a lever to accelerate alignment with the Taxonomy.

They have already started on this journey and their strategic objectives include mitigating and adapting their loan portfolios to the Taxonomy, with green-washing activities no longer considered sufficient. Although green financing initially led to improvements in costs and repayment structures, the current phase involves modifying the risk criteria and rejecting financing proposals that are not Taxonomy compliant.

For new builds developers adapt projects and specifications to the new requirements will be easier. However, the real challenge lies in existing buildings which are required to be carbon neutral by 2050 and in the new EPBD which will be a key factor in this transformation. This transition from Brown to Green requires capex which, in many buildings, will not bring sufficient returns.

There is no turning back in the transition of the real estate industry and the Taxonomy will condition the financing and, as a result, the liquidity and the value of assets.

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At the moment the new EU Taxonomy is *"simply"* a disclosure requirement - the main idea being that it, as a so called transparency tool, in practice will be *"an enabler of change and encourage the transition towards sustainability"* and encourage behavioural effects on financial firms. Regarding the real estate and buildings sector, several activities have been taken into account, including construction, renovation, acquisition and management of buildings and individual measures.

It would however be short sighted to say that compliance with the framework is simply a box ticking exercise. It is also reductive to say that compliance simply allows developers or funds to access a broader investor pool or obtain cheaper finance (although all that is true). ESG in Real Estate is here to stay, and I believe that it is to be expected that regulatory requirements will, in time, pass from simply disclosure requirements to more mandatory requirements (or at least have tax implications if not complied with).

It therefore makes sense for current compliance officers to look beyond the current framework and understand that a solid ESG policy already drives tenant demand and retention, adds value to a property (current specialist articles state that properties with poor ESG are priced at up to -10% and those with good ESG scoring can go up to +25%), and improves your company's reputation.

In summary: there is a clear correlation between ESG compliance, financial performance and investor, lender and tenant attraction.