

Hamburg, 14 December 2021

ESG REGULATION: THE TAXONOMY REGULATION TO TAKE EFFECT ON 1 JANUARY 2022

- ◆ Market shows serious unease over certain open issues
- ◆ Sustainable investment funds must quote their share of taxonomy-compliant real estate in future
- ◆ Regulation specifies requirements for sustainable real estate funds in the areas of new construction, renovation, acquisition and services
- ◆ Taxonomy not mandatory, as fund providers have the option to develop their own criteria
- ◆ Another part of the Taxonomy will take effect on 1 January 2023

The first stage of the EU's Taxonomy Regulation will become effective on 1 January 2022. It includes the requirements associated with the first two environmental objectives, these being climate change mitigation and climate change adaptation. The European legislature has thereby created an instrument whose purpose is to make sustainability measurable. The new rulebook has significant ramifications for all AIFM companies (including German KVG) that manage real estate funds. Here are the key changes: Going forward, the pre-contractual information of any investment fund that will pursue sustainability targets in future (Article-8 funds) or that is actively committed to more sustainability (article-9 funds or impact funds) will already have to specify the share of taxonomy-compliant real estate it will hold. Later on, the statements of account will have to report whether the set goals were indeed achieved. Funds that pursue no sustainability targets—also known as article-6 funds—must transparently communicate to their investors that these funds do not invest in taxonomy-compliant real estate. The EU lawmakers' objective: Sustainable investments are supposed to attract more private capital.

Hannah Dellemann, the ESG Officer at INTREAL, commented: "The taxonomy is the centrepiece of the European ESG regulation. It represents a rather comprehensive set of rules that took a group of experts several years to draft. Despite its complexity, a number of open questions remain, which is reflected in a strong sense of uncertainty among market players."

Taxonomy Specifications Cover Four Subject Areas

Which of the taxonomy contents refer to real estate? A group of technical experts worked out requirements in four areas: new construction, acquisition, renovation, and other services. Sustainability criteria have been defined for each of these areas. Dellemann commented on this subject: "An example from the new construction area are the specifications for the primary energy demand. The latter should be ten percent lower than the threshold values for ultra-low energy building effective in a given country. This aspect alone illustrates the issues besetting the taxonomy. No uniform national standards are in place for metrics like these. The problem is compounded by considerable differences from one property use type to the next."

Another example would be the requirements for acquisitions. A building completed before 1 January 2021 is considered to be taxonomy-compliant either if it has a Class A energy performance certificate or if it belongs among the top 15 percent of its class in terms of primary energy demand on a national or regional level. The problems that present themselves on the ground are evident here as there. How do you define the top 15 percent? Who decides what 'regional' means in this context?"

Michael Schneider, Managing Director at INTREAL, added: "The taxonomy is not a must-have requirement for launching an ESG investment fund, but an optional regime. An AIFM company could even launch an article-8 fund or article-9 fund without basing it on the taxonomy. Fund providers are at liberty to develop their

own criteria. These must be backed by convincing and consistent arguments. Of course, the Federal Financial Supervisory Authority (BaFin) will take a hard look at them before any fund shares are sold. The market appears to be divided on the subject at this time. We noted one group of providers who apply the taxonomy and another group who define their own criteria. For certain asset classes, the latter is the only option because properties that meet the strict criteria of the taxonomy are still in very short supply.”

In addition, it needs to be remembered that the rule book becoming effective at the start of next year is only the first part of the taxonomy, covering just two of the altogether six sustainability objectives. These two objectives are climate change mitigation and climate change adaptation. The technical criteria for another four sustainability objectives are currently in preparation. These are scheduled to become effective on 1 January 2023, a year hence. The four objectives are the protection of water and marine resources (1), the transition to a circular economy (2), pollution prevention and control (3) and the protection of healthy ecosystems (4).

Note on image rights:

Use of the attached image material is permitted solely for the purpose of covering the company INTREAL. Please be sure to cite the following source: INTREAL. Editing is limited to the scope of normal image processing.

About INTREAL

As a third-party AIFM, INTREAL concentrates exclusively on the business of launching and managing regulated real estate funds on behalf of third parties under the German Capital Investment Act (KAGB). The platform lets clients take advantage of all the options of a real estate AIFM without having to set up one in their own right. Options include the launching of open-ended and closed-end property funds or the outsourcing of AIFM back offices to INTREAL. Employing 383 staff, the INTREAL Group offers long-term real estate know-how along with detailed and highly professional fund management expertise.

INTREAL collaborates with a large number of third-party fund partners to administrate 257 investment funds with a combined investment volume of c. 46.6 billion euros (all figures as of quarter-end Q3 2021).