Now you can green stamp your real estate investment

In light of the European Union's aspirations to become the world's first climate-neutral continent by 2050, the stakes have never been higher to promote greener investments within Member States. A decade after the EU enacted Directive 2010/31/EU (the "**Energy Performance of Buildings Directive**"), the EU have enacted the EU Taxonomy legislation – a classification tool aimed at investors, companies and financial institutions to help them define whether an investment can be classified and marketed as being "green".

The introduction of the EU Taxonomy and underlying regulation is likely to affect the construction and real estate sectors significantly and will potentially have a major impact on the flow of capital within the market.

Considering that buildings are effectively the largest energy consuming sector in the EU, responsible for around 40% of energy consumption and 36% of carbon emissions, one of the key goals of the EU Taxonomy is directing investments towards more energy-efficient buildings. By enabling developers to access dedicated "green" financial instruments, the Taxonomy will stimulate much needed investment in this area. Market participants who do not upgrade their practices in line with the EU Taxonomy criteria may lose competitiveness and the ability to brand their economic activities and products as "green".

The Taxonomy Regulation

The EU Taxonomy was enacted by Regulation (EU) 2020/852 (the "Taxonomy Regulation"), which came into force on 12 July 2020. Under the Taxonomy Regulation, an economic activity (as defined therein) must meet four overarching conditions in order to qualify as being environmentally sustainable. The activity must:

1. Make a substantial contribution to the fulfilment of at least one of the EU's six environmental objectives:
   i) climate change mitigation;
   ii) climate change adaptation;
   iii) sustainable use and protection of water and marine resources;
   iv) transition to a circular economy;
   v) pollution prevention and control; and
   vi) protection and restoration of biodiversity and ecosystems;

2. Do no significant harm to any of the other environmental objectives;

3. Be carried out in compliance with minimum social safeguards (as outlined in Article 18 of the Taxonomy Regulation); and

4. Comply with technical screening criteria.

Although the Taxonomy Regulation has already come into effect, it provides for a phased implementation in order to allow the various parties involved to familiarise themselves with the objectives set out, and to prepare for their application. The Taxonomy Regulation provides that:

- From 1 January 2022, the provisions for climate change mitigation and adaptation come into effect;
- From 1 January 2023, the provisions for the remaining four of the EU's environmental objectives come into effect.

The Taxonomy Regulation is directly binding for financial market participants and large public interest entities (provided that they qualify under Directive 2014/95/EU (the "Non-Financial Reporting Directive")). For these entities, the Taxonomy Regulation contains a direct duty to report on their investments' or activities' alignment with the EU Taxonomy. However, the Taxonomy Regulation will also have an indirect effect on the real estate and building sector operators seeking financing for their investments from the market. These operators will be required to report on their economic activities as part of the finance provider's report.

The Taxonomy Regulation and the duty to report may mean more extensive reporting for the industry operators in order to access finance. The recommended alignment of the EU Green Bond Standard with the EU Taxonomy, signifying that EU Green Bond proceeds should go to finance or refinance economic activities that comply with the Taxonomy Regulation, may also be a big factor in industry operators obtaining finance.

The requirements set out in the technical screening criteria for the industry are also quite onerous. According to Article 9 of the Energy Performance of Building Directive, since 31 December 2020, all new buildings must be nearly zero-energy buildings. Under the EU Taxonomy, however, one of the requirements that a building must meet in order to qualify as being "green" is that it must have an energy requirement that is at least 20% lower than a nearly zero-energy building.

Other requirements include:

- The building must be able to withstand extreme rainfall, floods and increased temperatures;
- The building must have water-saving installations;
- At least 80% (by weight) of the non-hazardous construction and demolition waste generated on the construction site must be prepared for re-use, recycling or other material recovery;
- The building cannot be built in areas with a high biodiversity value;
- At least 80% of the wood materials used must be either recycled / reused or sustainably sourced and FSC / PEFC certified.

While the criteria in relation to the environmental objectives under the Taxonomy Regulation are still being considered and developed by the European Union, it is clear that industry participants will likely be subject to an increased compliance burden at both an investment and development level.

Therefore, it is clear that the question of obtaining "green'finance and investing in "green" economic activities may not be as straightforward as previously anticipated.

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