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## Construction, Real Estate activities and EU Taxonomy Report

By

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In July 2018 the European Commission (“EC”) established a Technical Expert GROUP (“TEG”) on sustainable finance in order to inform its work on the “*Action plan: financing sustainable growth*”.

EC released a proposal for a regulation on the establishment of a framework to facilitate sustainable investments (taxonomy regulation). Within the framework of the proposed taxonomy regulation, the TEG has been asked to develop recommendations for technical screening criteria for economic activities that can make a substantial contribution to climate change mitigation or adaptation.

On 18 June 2019, the TEG published its Technical Report on EU Taxonomy that sets out the basis for a future EU taxonomy in legislation

Report contains:

- Technical screening criteria for 67 activities across 8 sectors that can make a substantial contribution to climate change mitigation;
- A methodology and worked examples for evaluating substantial contribution to climate change adaptation;
- Guidance and case studies for investors preparing to use the taxonomy.

In addition to its technical report, the TEG also published a supplementary report on using the taxonomy providing investors and companies with a

concise and clear explanation of why the taxonomy is needed, what it looks like and its ease of use.

The TEG report on EU taxonomy has been accompanied by a call for feedback which was held from 3 July until 16 September 2019. In the autumn, the TEG will analyse the response and advise the Commission on how to take the feedback forward.

At the end of its mandate that has been extended until the end of this year, the TEG will make further recommendations to the European Commission on the need to adjust and complement their work on an EU taxonomy. The TEG's recommendations are designed to support the European Commission in the development of future delegated acts, as proposed in the taxonomy regulation.

The Report contains a full list of technical screening criteria in form of an annex that sets out the sectors and economic activity specific technical screening criteria and rationale for the TEG's analysis.

Among these activities *Construction and Real Estate* are addressed as detailed ones with a direct impact on climate change mitigation.

In the EU, buildings are effectively the largest energy consuming sector, responsible for around 40% of energy consumption and 36% of carbon emissions. Three-quarters of the European building stock is considered inefficient, but renovation rates remain very low, around 1% per year. Annual rates of new construction resulting in buildings with higher performance levels differ across EU Member States but are generally estimated to be around 1-2%, clearly inadequate to set the whole sector on a zero-emissions pathway.

Given that building emissions are heavily dependent on the carbon intensity of the grid, the TEG acknowledges that it is necessary to look at both energy demand and Greenhouse Gases ("GHG") emissions as metrics to evaluate a building's performance. However, feedback received through consultation with financial institutions and developers has shown that, in practice, the majority are not ready to use GHG emissions metrics to assess the performance of their activities and assets. Against this background, the TEG has decided to adopt a transitional approach based on the initial decision to use energy metrics, which will be extended to include GHG emissions once sufficient data for the latter is available.

The TEG acknowledges that sector emissions are not only caused throughout

a building's operational phase but that significant emissions are generated during the extraction, manufacture and transport of building materials, as well as during the construction process and through the end-of-life demolition process. Due to current whole life cycle GHG emissions data constraints, the TEG chose to focus on the operational phase. However, the TEG strongly recommends the establishment of additional GHG emissions thresholds once more robust data becomes available.

### Detailed activities

The TEG has focused on four individual economic activities, enabling the Taxonomy to establish mitigation criteria that are consistent with and relevant to a large group of real estate market participants and can maximise investment flows to mitigation actions within the building sector. Consistency of the criteria across the four activities should be maintained once absolute thresholds are established.

#### Economic activities:

1. Construction of new buildings: This activity covers real estate development and enables accounting project capital expenditures of construction clients and the equity/revenues of developers and construction companies as eligible under the Taxonomy.
2. Renovation of existing buildings: This activity includes both relative improvements (30% against baselines) and comprehensive interventions on buildings and enables accounting project capital expenditure of renovation clients (including renovation costs unrelated to energy efficiency measures) and the equity/revenues of renovation companies as eligible under the Taxonomy.
3. Individual renovation measures, installation of renewables on-site and professional, scientific and technical activities: This activity covers a) single technical interventions, enabling the accounting of project capital expenditure of clients (including only costs related to the eligible measures) and the equity/revenues of installation companies; and b) services functional to building performance improvement, enabling the accounting of project capital expenditure of clients and the equity/revenues of companies offering such services as eligible under the Taxonomy.
4. Acquisition and ownership of buildings: This activity covers the purchase of buildings, building ownership and improvement from an asset perspective and enables accounting project capital expenditure (related to the

acquisition) and the revenues/equity of the owner as eligible under the Taxonomy. This activity covers portfolios and real estate trusts.

The criteria established for building acquisitions follow the same rationales as the construction of new buildings and the renovation of existing ones. Future iterations of the Taxonomy should maintain this alignment within building-related activities and the associated level of ambition by updating the criteria for building acquisitions in accordance with the changes that will be introduced in the criteria for new construction and renovation.

Market introduction of the Taxonomy will have both beneficial and adverse effects on the sector. By enabling owners and developers to access dedicated 'green' financial instruments, the Taxonomy will stimulate much needed investment in construction and the acquisition of new efficient buildings as well as the renovation of buildings with lower levels of performance. Market participants who do not upgrade their practices in line with the Taxonomy criteria may lose their competitive edge and ability to brand their economic activities and products as 'green'. The TEG acknowledges the risk of creating stranded assets, but it feels that sufficient safeguards have been included in the criteria to adequately manage this possibility.

In terms of implementation costs, the Taxonomy will affect market participants differently. The Taxonomy eligibility of new construction, renovation and acquisitions can result in additional costs in comparison to business-as-usual practices. Market participants may incur further costs due to the process required to demonstrate eligibility with the Taxonomy thresholds, especially when the latter are based on several technical parameters. However, during the transitional period, several Taxonomy requirements will be de facto requirements in EU Member States and will therefore not induce additional costs. Once absolute thresholds are established by benchmarking the top 15% of the local stock in terms of energy and GHG emissions performance, ancillary costs associated with achieving and demonstrating eligibility may increase.

Overall, considering the importance of ensuring high standards in new construction and the renovation of existing buildings, the impact of implementation costs can be considered proportionate to the goals of the Taxonomy, especially as the successful implementation of the Taxonomy will have significant positive environmental and social impacts. Requiring high standards for new buildings and improving the performance of existing ones will reduce energy bills and improve indoor air quality and thermal comfort, positively impacting occupants' health and available income. Requiring high standards for new construction and renovations will likely stimulate the demand for sustainability professionals and service providers and skilled

construction workers, thus providing employment opportunities. The eligibility of individual measures and installation of on-site renewables will also boost the market for low-carbon technologies.

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The main steps for the future shall be:

- Development of the absolute thresholds for primary operational energy, followed by operational GHG emissions and then eventually embodied GHG emissions.
- Development of additional criteria for the inclusion of operational management of buildings.

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