

**Real estate and taxonomy:
how will taxonomy become
the new environmental frame of
reference?**

January 2022

The concept of sustainable development has suffered from a major flaw since its inception: how can we identify whether an activity or an asset respects the definition of this concept "to meet the needs of the present without compromising the ability of future generations to meet theirs"? In the absence of a threshold or measurement tool, the term sustainable is widely used, but it is difficult to distinguish between what is communication (misleading or not) and what really contributes to environmental, social or governance objectives.

*It is true that many labels can attest that the means and processes have been put in place to ensure this "sustainability". However, like the French ISR label, **they do not always define a threshold and are not always shared beyond our borders.***

*This is the ambition of this European Green Taxonomy: **to define a European reference system to objectively measure the fact that an activity contributes to the environmental objectives of sustainable development.** This regulation can be compared to a yardstick to measure the "green part" of a company among all its activities. The final objective of this taxonomy is to direct financial flows towards the greenest activities that it will allow to identify more objectively. A social taxonomy will complete this green taxonomy.*

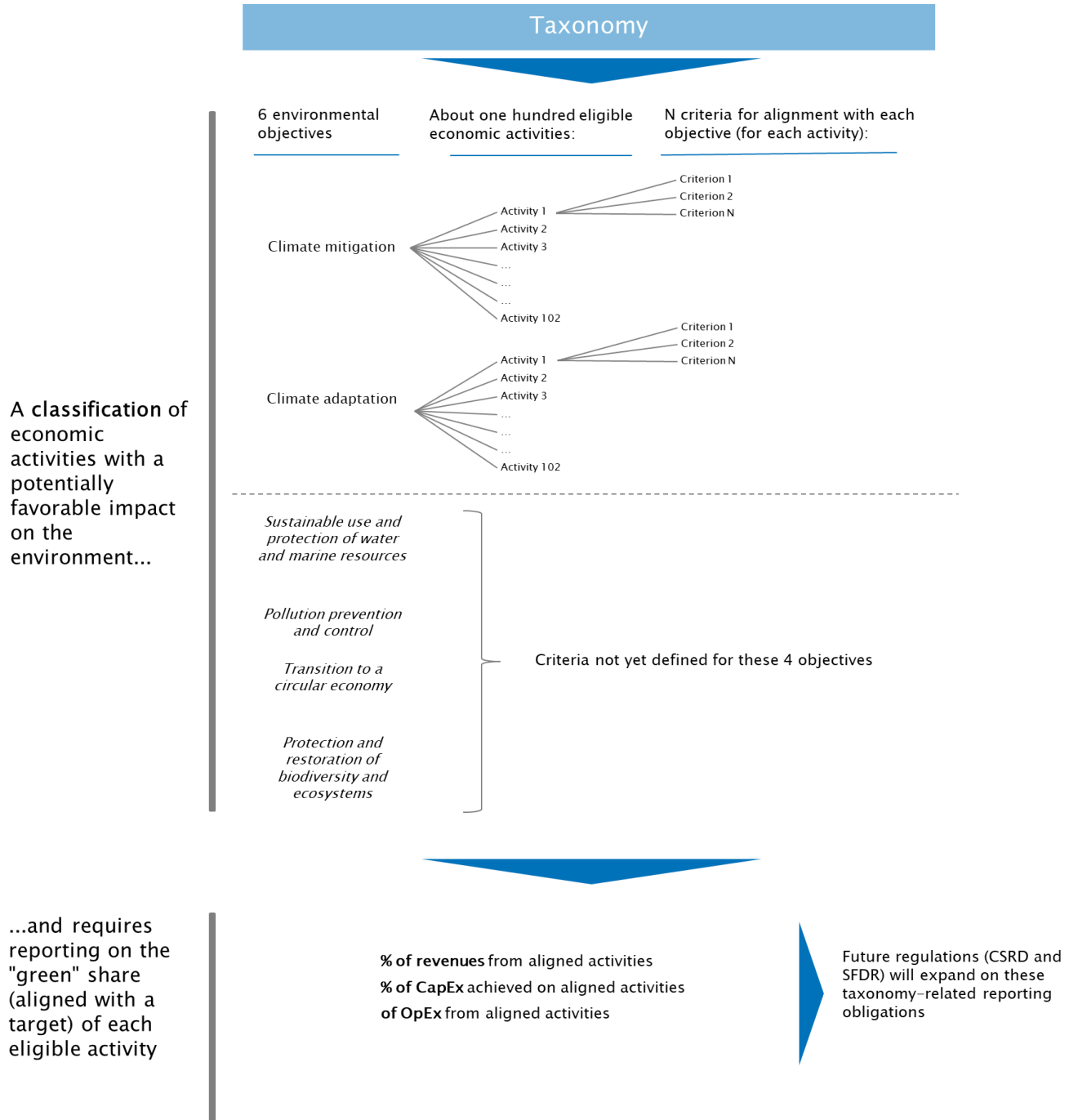
*Within the framework of the green taxonomy, six objectives have been defined. Companies will have to choose one of these six objectives and determine the eligibility and then the green share of their activities. **By the end of December 2021, the two climate targets (climate change mitigation and adaptation) and their respective criteria for achieving them have been published.** The other four environmental targets (on water, pollution, waste and ecosystems) will be implemented in January 2023.*

*This document specifies **the conditions of application of the green taxonomy to the real estate sector for the two objectives whose criteria have been published.***

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1. Taxonomy in short



2. The companies concerned and the deadlines

2.1. Several texts will require reporting on the "green share" with reference to the taxonomy

The taxonomy is a benchmark for defining the extent to which the activities of a company (or the activities of companies in which it proposes to invest) contribute to the environmental objectives of sustainable development. The objective is for the companies concerned to make this information known to the market.

However, several European texts will soon govern the publication of non-financial information imposed on companies. These texts will therefore impose a communication on this green share, with reference to the taxonomy.

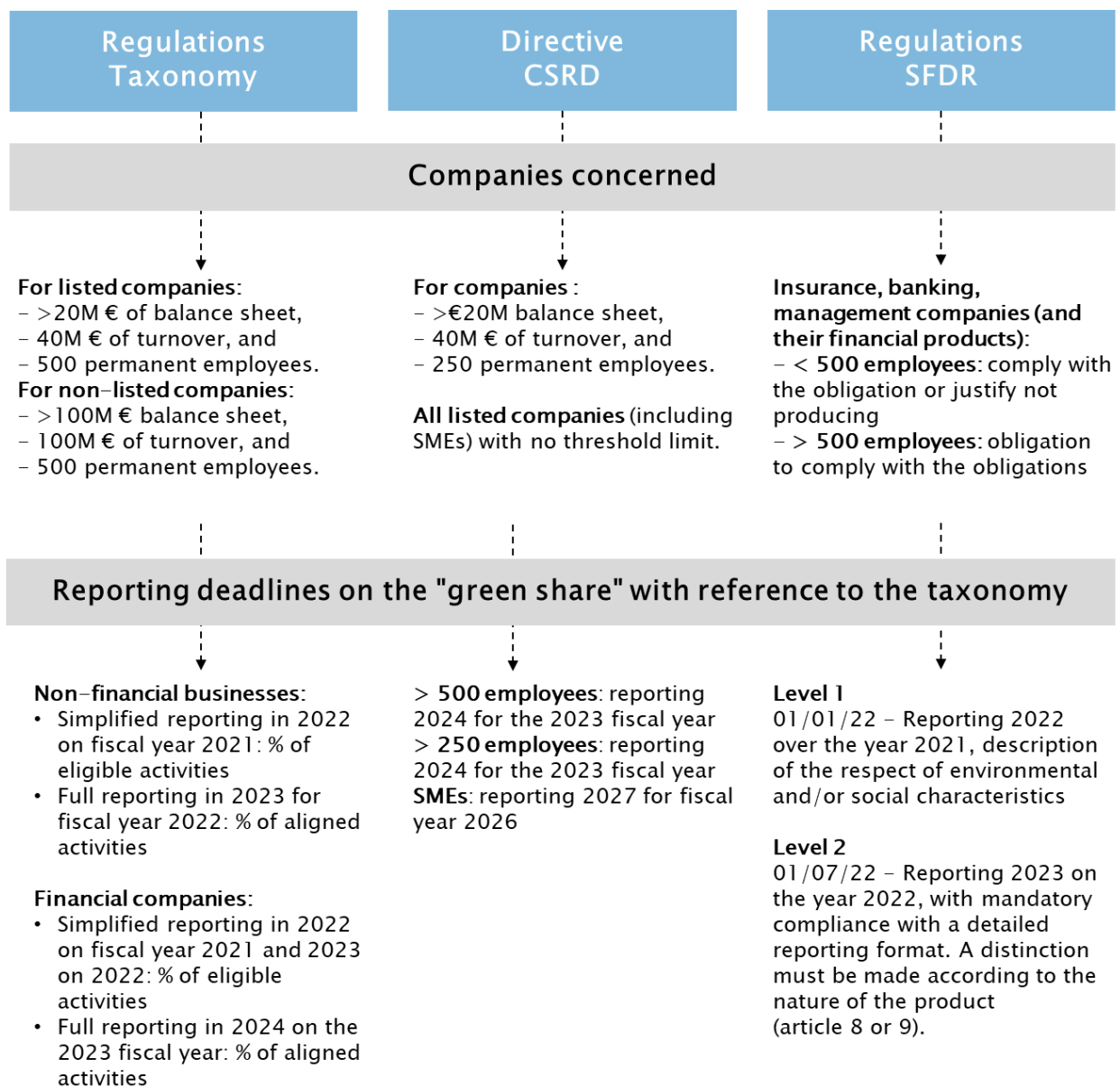
The taxonomy itself also includes reporting obligations. The reporting obligations relating to the share of a company's "green" activities are therefore covered by the **Taxonomy delegated act** published on December 10, 2021, but also by the **CSRD**¹ (for the activities of companies) and **SFDR**² regulations for the activities of companies in which asset managers, investment companies or financial advisors propose to invest.

N.B.: to these texts, we must add article 29 of the Energy & Climate law and its application decree which, as far as taxonomy is concerned, take up the obligations of the SFDR regulation.

¹ Corporate Sustainability Reporting Directive

² Sustainable Finance Disclosure Regulation

2.2. Companies concerned and reporting deadlines for the "green share" in reference to the taxonomy



N.B.: the CSRD deadlines are provisional and appear ambitious for some actors. As the first standards are expected to be adopted in 2022, this proposed timetable would leave only one year for stakeholders to organize the collection of reliable information and then to report it in an organized manner.

3. « Eligible » real estate activities

The term "eligible" can lead to confusion because it should be considered that it is **actually the activities concerned by the regulation**. These are activities selected **at this stage by the European Commission which are likely to make a substantial contribution to each environmental objective**. **The notion of eligible activity thus constitutes a first filter of the activities that can be qualified under this regulation.**

For the real estate sector, the following activities are eligible for the Taxinomy:

- construction of new buildings → REITS, property developers
- renovation of existing buildings → REITS, funds
- acquisition and ownership of buildings → REITS, funds
- installation, maintenance and repair of energy efficiency equipment
- installation, maintenance and repair of electric vehicle charging stations in buildings (and parking spaces attached to buildings)
- installation, maintenance and repair of instruments and devices for measuring, regulating and controlling the energy performance of buildings
- installation, maintenance and repair of renewable energy technologies

This document presents the modalities to define, for a company, the "**share of green activities**" for the first three activities mentioned above. However, the main steps are the same for each activity, only the criteria are specific to each of them. The list of activities and criteria to be complied with can be found on the European Commission's website: https://ec.europa.eu/sustainable-finance-taxonomy/tool/index_en.htm

4. The concept of "aligned activity share"

The goal of the taxonomy is for companies to communicate the "green share" of their activities. It refers to the "aligned share of business", although this may seem like a misnomer.

An activity is either eligible or not (see II.). **In contrast, the concept of alignment is expressed as a percentage.** Thus, for a company, we will determine the share of green economic activities, i.e. **the share of activities "aligned" with the taxonomy.**

*Although the texts seem at first glance to position the analysis at the level of the activity, according to our understanding, **the published criteria show that the "share of aligned activities" in the real estate sector must result from an analysis at the level of the assets or operations.** Indeed, the criteria defined by the European Union concern the outcome of the activity and not the processes associated with this activity.*

For example, a real estate company owns two assets (A and B).

– Asset A generates a turnover of 3M€ and asset B of 5M€.

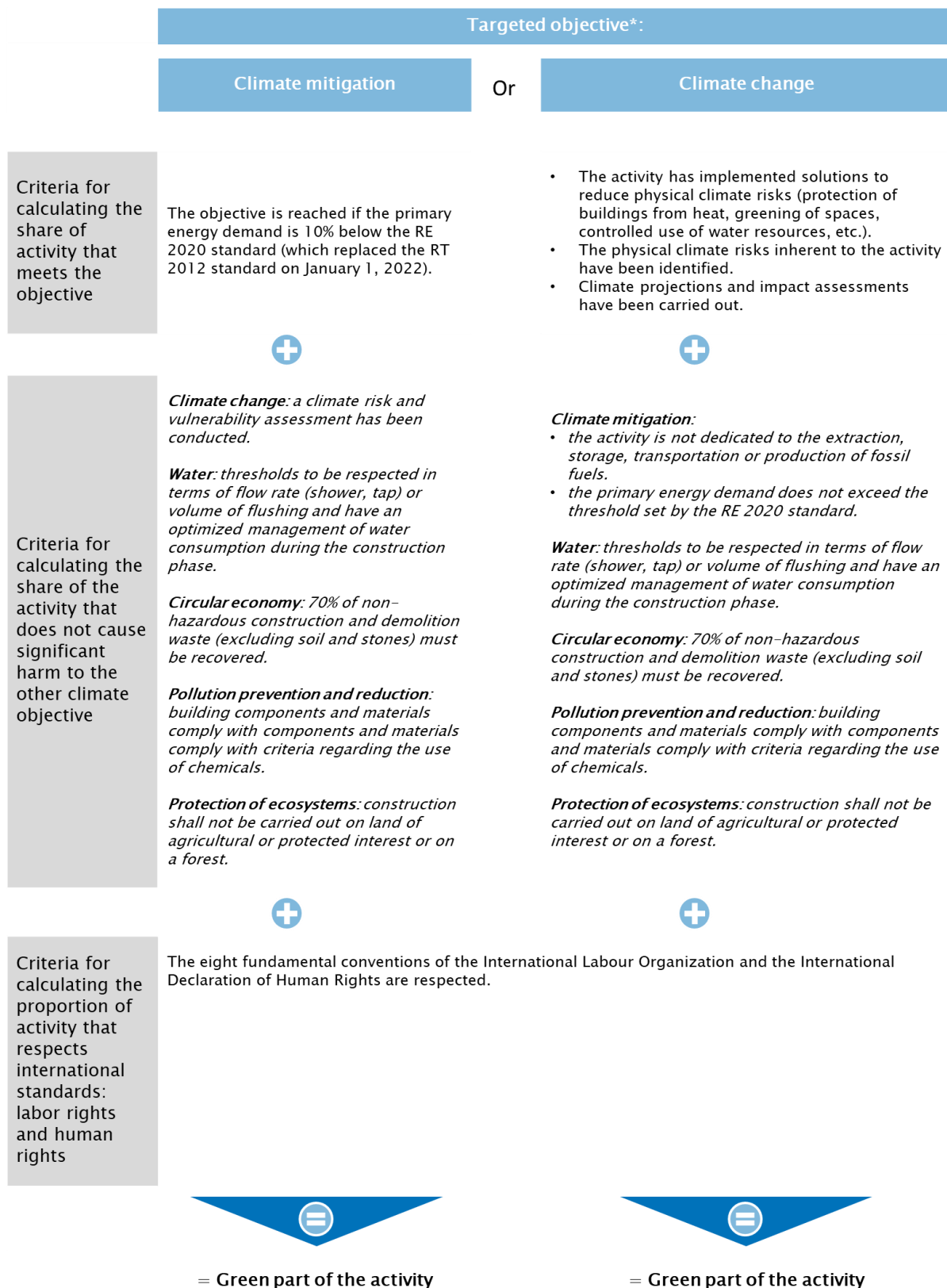
– Asset A does not meet the net energy consumption criterion, while Asset B meets all the alignment criteria (see criteria in IV).

The aligned turnover for this activity is therefore 5/8, or 62.5%.

This operation must be repeated for each activity of the company if it has several, and for all the indicators detailed in part V of the regulation.

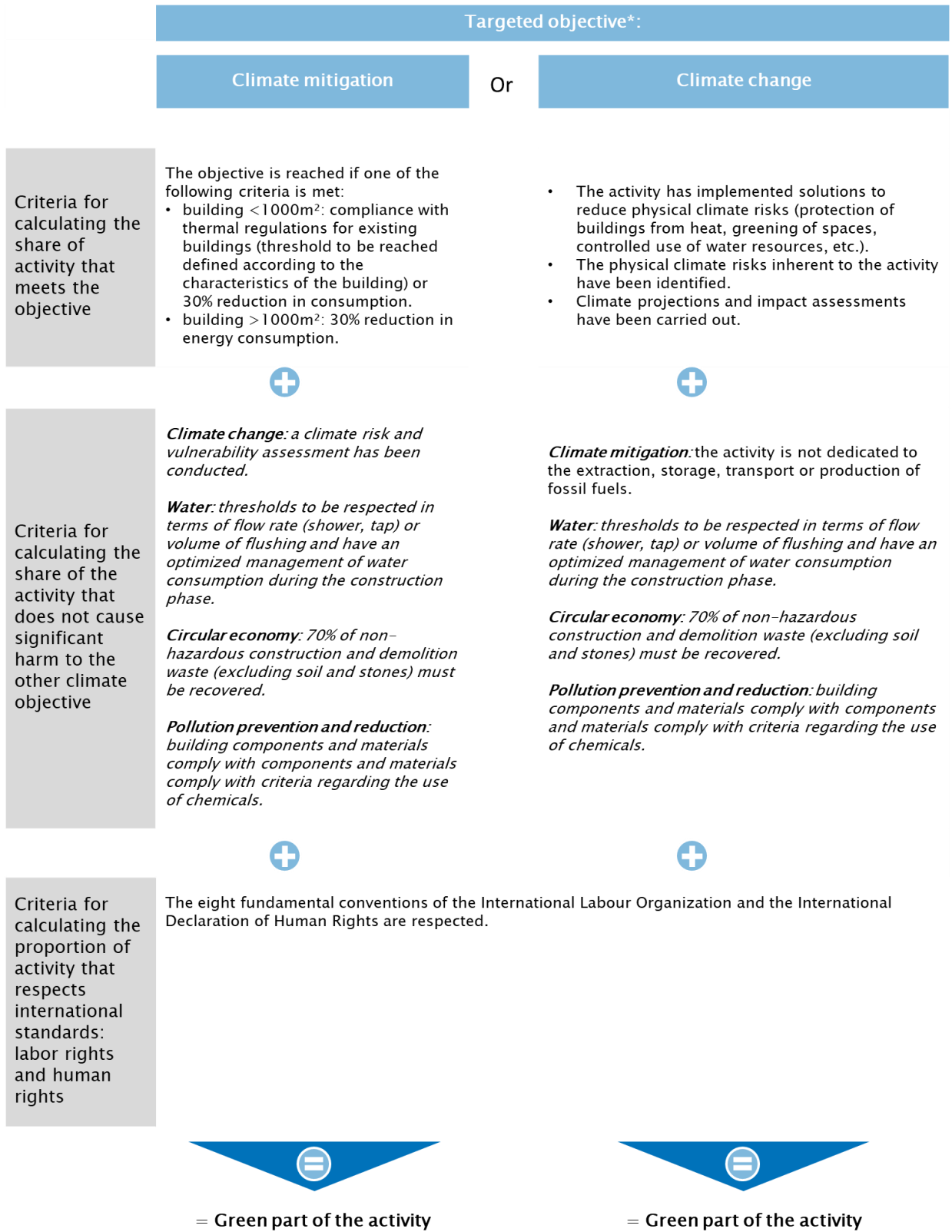
5. Methodology for calculating the percentage of aligned activities...

5.1. ... for the activity of construction of new buildings



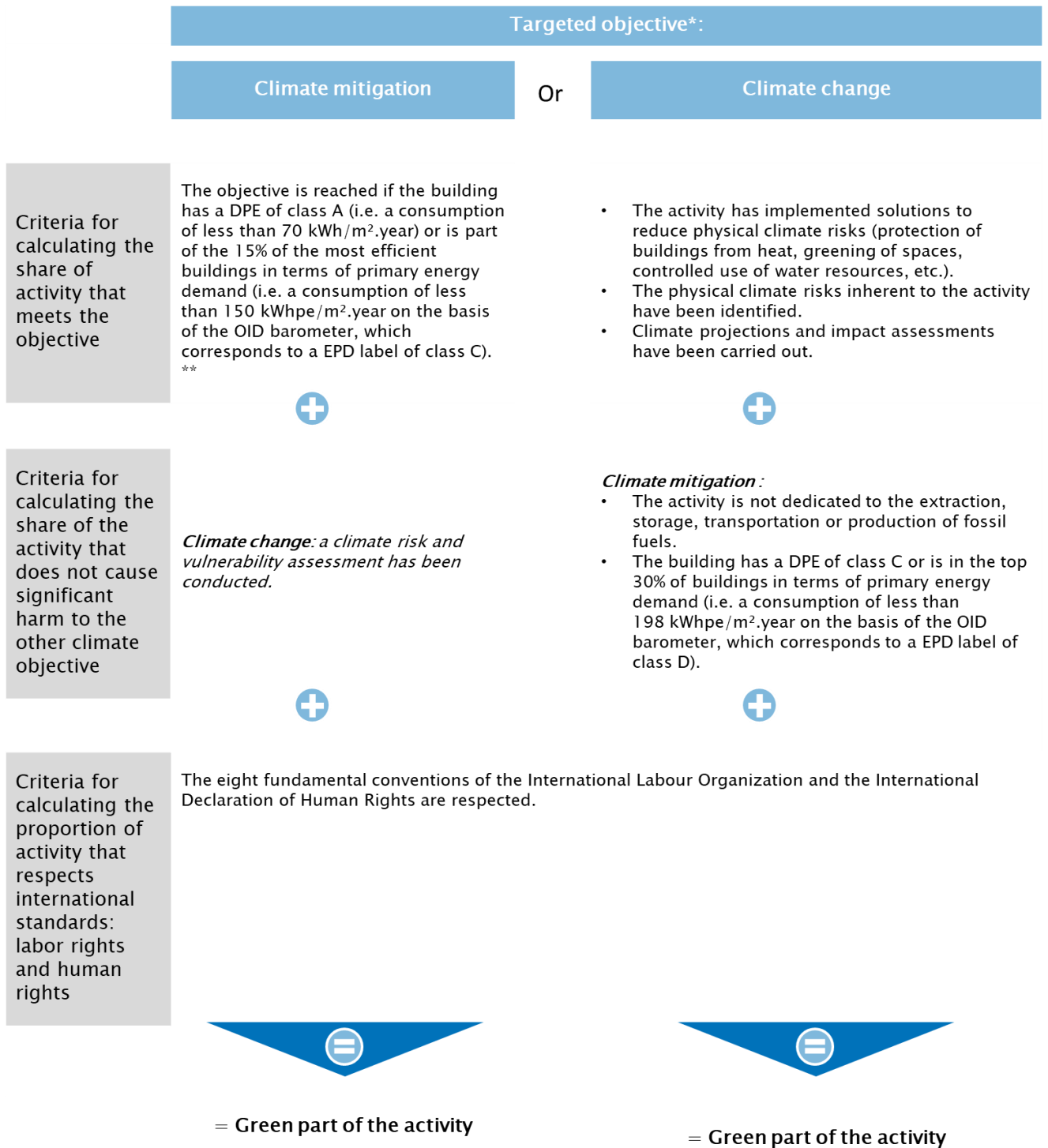
* 2 climate targets have been set for January 2022, 4 environmental targets will be applied in 2023.

5.2. ... for the activity of renovation of existing buildings



* 2 climate targets have been set for January 2022, 4 environmental targets will be applied in 2023.

5.3. ... for the activity of acquisition and holding of buildings



* 2 climate targets have been set for January 2022, 4 environmental targets will be applied in 2023.

** Buildings constructed after 2020 must meet the targets and criteria.

6. What are the reporting obligations on the share of aligned activities?

6.1. Within the framework of the taxonomy regulation

In the framework of the Taxonomy regulation, three "KPIs" (key performance indicators) have to be published to report on the weight of sustainable activities in the sense of the Taxonomy:

- % of revenue;
- % of CapEx;
- % OpEx.

The annexes to the Commission Delegated Regulation 2021/2178 (<https://eur-lex.europa.eu/legal-content/FR/TXT/?uri=CELEX%3A32021R2178&qid=1641202797716>) present the KPIs to be published for the actors concerned (**non-financial companies, asset managers, credit institutions, investment firms, insurance and reinsurance companies**). For each player and for all the required KPIs (relating to turnover, capital expenditure, operating expenditure), **the calculation rules, models and variations of these calculations are detailed.**

Other texts will also require the determination of the share of aligned activities. These include the CSRD directive and the SFDR regulation.

6.2. Within the framework of the CSRD

As for the CSRD, which will be implemented in 2024, the indicators have not yet been determined; the standards will be adopted in 2022. Nevertheless, the objective of this directive is known: more than a reporting tool, this regulation is being implemented in order **to standardize the extra-financial communication of companies**. By proposing homogeneous, readable and usable reports, the CSRD makes it possible to highlight the steps taken and the results obtained for the climate issues addressed.

6.3. In the context of the SFDR regulation

More extensive than simple reporting obligations, the regulation provides the **communication of a large amount of information to investors**. Concerning the use of the taxonomy, **a template will have to be filled in with additional KPIs** (by type of counterparty, according to the objectives pursued by the investment...). Two levels of SFDR reporting have to be distinguished:

- Level 1 reporting, which describes the measurement of compliance with environmental and/or social characteristics,
- Level 2 reporting, produced in the context of mandatory compliance with a detailed reporting format. A distinction must be made according to the character of the product, i.e. whether it has a sustainable investment objective or whether it promotes sustainable characteristics. For these two characteristics, we find the distinction between aligned and non-aligned assets.

7. Conclusion

The ambition of the text is perfectly legitimate but the challenge is considerable. The identification of eligible activities and the definition of criteria adapted to each country are major pitfalls. This document provides a first approach to the operational implementation of this regulation in the real estate sector. It will allow each of us to better understand it... And investigate it more!

This is therefore the challenge of the coming period: to identify in detail the questions that arise for the operational implementation of this text so that companies can use this taxonomy with an easy mind. The challenge is all the more important as several texts will refer to the taxonomy.



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