REAL ESTATE - THE TIMES THEY ARE A CHANGIN

26 October 2017

In case you missed it, Europe is at war with carbon to save our planet. Some of the world's toughest environmental targets are becoming a reality in the way we live our lives and conduct our business. Europe has committed to reduce its greenhouse gas emissions by 40% of 1990 levels by 2030. But the need for speed is gathering pace. Buildings are firmly on the legislative agenda. The built environment is responsible for 40% of total energy consumption and 36% of CO_2 emissions in the EU. 75% of buildings are energy-inefficient. Not the best statistics considering the context.

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Introduction

Anyone who has followed the diesel-gate scandal will see how vociferous the campaign has become to reduce the impact of vehicle emissions on climate change and public health. The debate has evolved rapidly, rattling industry and its ability to respond effectively to the point where the future need and role of the internal combustion engine itself is being challenged – an impossible scenario anyone in the automobile industry would have predicted less than 18 months ago. It mirrors a revolution more than an evolution.

Now cut to real estate. Evidence exists that if energy efficiency of Europe's buildings stock was improved, the EU could reduce energy consumption by 5-6% and lower CO_2 emissions by 5%. The EU clearly feels the time to move up a gear has come.

While the overarching objective is climate change, the legislative debate that is emerging is twofold. The first is driven by the need for greater energy efficiency, using less of it in a better way, to assist the move away from fossil fuels and Europe's dependency on foreign imports. The second is to tackle these dreadful statistics to make our buildings greener with lower carbon footprints, promoting the need to build green and drive renovation levels.

The challenge is huge. 35% of Europe's buildings are over fifty years old and waste enormous amounts of energy. The real estate sector is moving at a snail's pace. Depending on which Member State you live in, the current rate of renovation is only 0.4% to 1.2% of total building stock per year being converted. Despite an additional commitment that all new buildings must be nearly zero-energy buildings by the end of 2020 – and all new public buildings by December 2018 - the EU will struggle to meet its targets. It is estimated it would take almost a century to decarbonise the existing building stock.

Rates need to triple to have any chance of delivering real change. The horror of the Grenfell Tower tragedy in West London is a testament to the consequences of getting things wrong.

The danger is that policy is moving quicker than industry is able to keep up. Two pieces of legislation are progressing through Brussels that will have a significant impact on the real estate sector from a regulatory perspective. Beyond the politics and commercial realities, business needs to be alert to the potential consequences. The move to a greener, cleaner planet and the relationship that industry has with public opinion are witness to how fast the speed of change could go.

So what's happening in Brussels?

On 11 October an important piece of legislation passed a first important hurdle in the European Parliament. Its Committee on Industry, Research and Energy (ITRE) overwhelmingly voted (51 approvals, 1 abstention, 11 against) for the Energy Performance of Buildings Directive (EPBD) to go forward for further consultation with the European Parliament and then the Council. This is a huge boost for a piece of draft legislation that seeks to completely decarbonise the EU's building stock by 2050. If adopted it will have a significant impact on how Europe manages its real estate.

What is the policy context?

In October 2014, the European Council agreed on the EU 2030 Climate and Energy Framework. In 2015, a proposal to reform the EU Emissions Trading System (ETS) to ensure industries deliver necessary emission reductions was integrated into the Framework. Targets for reducing non-ETS sector carbon emissions, including buildings, seek to reduce affiliated emissions by 30% (as compared to 2005 levels).

The principal was reiterated with the publication of the 'Clean Energy for all Europeans' package (*The Winter Package*) in November 2016. With the package the Commission set out to turn its ambitious targets into legislation and to strengthen the EU's energy markets. When referring to buildings the Winter Package states that clean energy and energy performance of buildings is needed to achieve the Union's climate goals. As part of the Clean Energy Package the EU is progressing legislation to reduce energy consumption across Europe. Real estate has been singled out as the sector with the biggest energy saving potential.

The Package includes two legislative proposals focusing on energy efficiency. A proposal for an updated Energy Efficiency Directive including an increase of energy efficiency target from 20% to 30% by 2030 that is binding at EU level. For buildings specifically the Energy Efficiency Directive proposal aims to put in place the right market conditions to increase the rate of renovations across Europe.

The proposal for a revised EPBD has the objective to increase refurbishment of old buildings; bolster the use of smart and energy efficient technologies and, increase sustainable energy consumption. In addition, it aims to address the energy poverty affecting 23.3 million European households (Eurostat). More specifically it makes provision for:

- The introduction of well-defined national milestones and actions for energy efficiency to achieve short-term (2030), mid-term (2040) and long-term (2050) objectives
- The use of 'smartness indicators' to help reduce energy consumption and adapt buildings to the needs of its occupants
- Appropriate infrastructure for electric vehicles in all new buildings and to those undergoing major renovation. This will require electrical recharging and parking infrastructure in buildings with more than 10 parking spaces, for example.

Understanding the key issues

As the EPBD progresses through the legislative process, the reality is that the real estate sector could be about to enter into a major period of change. Beyond the straight commercial interests of supply and demand, the need for change could be about to overhaul how the sector invests, builds and delivers the type of buildings we live and work in. The need for green may no longer be the preserve of the flagship developer for the multinational tenant. It could well be coming to a street corner near you, very soon. But issues and challenges remain.

While some markets are more mature than others, with larger portfolios of assets under management and institutional investors to satisfy, the majority of Europe's real estate remains in the hands of many private individuals, whether commercial and residential. This makes it difficult to offer holistic solutions on a broad scale as renovations usually involve multiple partners and disciplines.

Another challenge is how the EU can update all existing building stock (retrofitting), rather than knocking everything down and starting from scratch. Many developers are also risk adverse, avoiding taking on longer term, more time-consuming and risky projects which creates a double challenge: increasing building renovation rates while aiming at achieving '*deep renovations*'.[1] A quality vs. quantity issue. However deep renovation of existing building stock will inevitably have greater impact in terms of climate change targets.

A more concerted effort will be expected between the public, private sectors and civil society to reduce emissions in the construction sector, drive agreed goals and the means to achieve them.

Agreement on zero-energy buildings needs to be reached on rules and definitions and how they transfer to different climates, building types and building traditions in a way that reflects differing circumstances and allows flexibility without leading to overly complex rules.

For investors it is more expensive to 'build green' than to 'sell green'. Attitudes may be about to change but given the reality of the long investment cycles of buildings, infrastructure funded and implemented in the near term will still be in place in 2030. Fund managers will need some sort of guidance as they look to balance their portfolios.

Next steps

The revised EPBD is now being discussed in the European Parliament which will vote on the proposal before the end of the year. The European Council representing the 28 Member States (including the United Kindom) is discussing the proposal in parallellooking to develop a common position to negotiate the file with the European Parliament. If all goes well the file can be fully adopted in the 3rd quarter of 2018, which seems realistic as there is a fair degree of mutual agreement and support for the principles that the EPBD is seeking to drive. No major objections have been raised to date.

> "It is vital that member States show a clear commitment and take concrete actions in their long-term planning. This includes facilitating access to financial tools, showing investors that energy efficiency renovations are prioritised, and enabling public authorities to invest in well-performing buildings"

Bendt Bendtsent (Rapporteur behind the EPBD, Danish MEP)

So from mid-2018, we are likely to see a position where Members States will have to implement the new Directive. How this is done will be a prerogative requiring national legislation. The real estate sector already has its green credentials but the outcome of this process could see a significant shift in how this is enforced, how quickly and to a scale not seen before.

[1] Definitions vary. Global Buildings Performance Network (GBPN states that it is a term used for renovation that captures the full economic energy efficiency potential of improvement works with a factor of 75% or more compared to before. For EC, deep renovations typically achieve more than 60% energy savings compared to pre-renovation levels.

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