WARBURG-HIH INVEST
REAL ESTATE

PRESS RELEASE

Outlook: ESG Regulation Progressing in Leaps and Bounds in 2021

- Some parts of the Sustainable Finance Disclosure Regulation mandatory by 10 March 2021
- Further specification of level 2 taxonomy regulations criticised
- Large sections of the SFDR and taxonomy provisions to become effective in late 2021
- Comprehensive effort by the real estate industry required
- Strong demand and need for clarification on the investor side

Hamburg, 28 January 2021 – With the new year getting started, the regulatory efforts concerning ESG aspects have gathered fresh momentum. While many questions remain unanswered, new requirements are coming into force. A major milestone will be 10 March 2021, the day when the German Sustainable Finance Disclosure Regulation (OffV) will become effective. Other important milestones will be marked by the Level 2 regulations (implementing regulations) governing both the Sustainable Finance Disclosure Regulation and the Taxonomy Regulation whose bill has yet to be finalised. In late 2021, far-reaching requirements codified in the Taxonomy Regulation and Disclosure Regulation will come into effect. A year from now, stakeholders will have a much clearer idea what the ESG regulations and what ESG compliant investment funds will look like.

Alexander Eggert, Managing Director at Warburg-HIH Invest, commented: “Many of the abstract questions regarding the ESG regulation that remain open at this time will be answered in the course of the year. The subject of ESG will—together with the issues of COVID-19 and digitisation—occupy as throughout the year. On top of that, ESG should no longer be understood as a trend but as centrepiece of corporate and product strategies. In this regard, attitudes began to shift some time ago. The industry is now taking a comprehensive approach to prepare for the new requirements. Efforts already under way will need to be carried forward in the year just started. The time line is short, and demand for ESG compliant funds will increase considerably. There are push factors, such as the regulations and the media pressure and civil society, and then there are pull factors that also come into play. These include specifically institutional investors who request ESG compliant products, but also market opportunities created by new sustainable business models. Especially for early movers, introducing ESG compliant products could pay off. Apart from market- and regulation-related factors, integrating ESG aspects in a comprehensive approach on the corporate, product and asset level should be part of an active investment strategy.”

Taxonomy: Level 2 Draft Regulation Criticised

The taxonomy is the centrepiece of the ESG regulatory effort. Its purpose is to create an EU-wide classification system for economic activities that qualify as environmentally sustainable. It takes the form of a checklist that is supposed to make the level of sustainability measurable. The regulation was passed in summer 2020. At its core, it is based on a 600-page report by a technical group of experts (TEG) that specifies a strict regime of requirements for various economic sectors, including for the construction and real estate industry. As is often the case with EU regulations, the wording of the regulation is further specified in Level 2 delegated acts. In the case of the Taxonomy, the EU Commission submitted its draft delegated act for consultation on 20 November 2020. The draft consists of 15 pages plus two annexes of 233 and 281 pages, respectively. The consultation ended on 18 December 2020. The Commission was harshly criticised, e. g. by 123 scholars from all 27 EU member states, including by all professors from the TEG group of experts. The key issue being: The criteria proposed by the TEG are based on the CO2 caps for economic activities that are to be brought down to zero by 2050, the year by which the EU plans to be carbon-neutral. This approach is not reflected in the Level 2 Regulation.

Iris Hagdorn, Head of Sustainability at Warburg-HIH Invest, elaborates the situation: “It is anybody’s guess how the Commission will respond to the criticism. Yet the criteria will have to be developed near-term because they are supposed to come into force by the end of 2021. The Commission has to decide whether and in what way it will respond before adopting and publishing the final version of the Level 2 Regulation. This should happen before the end of Q1 2021 in order to ensure a timely implementation. Next comes the customary four-month review period for the EU Parliament and Council before the regulations take effect. The first obligations under the Taxonomy are supposed to be applied by 1 January 2022, with other obligations to become binding by 31 December 2022 at the latest. Iris Hagdorn added in regard to this point: “Given the complexities of the issues, companies will have little time left to get ready. The fact that many aspects remain open issues is just making things harder yet.”

Sustainable Finance Disclosure Regulation (OffV): Level 1 Implementation Becomes Mandatory by 10 March 2021

The second major regulatory project, the Sustainable Finance Disclosure Regulation (OffV), is also progressing in stops and starts. The purpose of the law is to compel financial market players to show transparently in what sense they meet the ESG criteria or ESG targets or in what ways sustainability risks are taken into account. Originally, the entire regulation was supposed to come into effect on 10 March 2021. But here, too, things stalled over Level 2 regulations, which have yet to be finalised. As result, businesses will only have to meet the requirements of the actual Regulation (Level 1) as of 10 March 2021. These mandate that property funds should principally provide sustainability disclosures in three separate instances: the sales prospectus, the annual report, and the homepage of the AIFM company. The Level 2 measures are expected to be presented by the end of January 2021. Their implementation will become mandatory by year-end 2021.

Iris Hagdorn commented the matter: “The objective here is a transparent, sustainability-focused disclosure – just like on the company homepage. The transparency obligations include, for example, information whether and how investment decisions take ESG risks into account, and information about the most adverse consequences that an investment decision is likely to have for sustainability factors. Beyond that, the Sustainable Finance Disclosure Regulation governs other transparency obligations on the product level in the sales prospectuses, on the own homepage and in the periodic reports."

Alexander Eggert elaborated: "As of 10 March 2021, AIFM companies will be under a binding obligation to comply with the Sustainable Finance Disclosure Regulation, which is already on the table. The problem here is that the addition of Level 2 requirements at a later date may necessitate adjustments. At least for investment funds with ESG characteristics and for impact investment funds, this will most likely be the case. Fund providers now need to prepare for the key date of 10 March 2021 and compile the ESG product information on the company level and product level, which they will need to disclose on their homepages, in their prospectuses and in their annual reports. These efforts will coincide with the start of preparations for the Level 2 Regulations – as soon as they become available – to be able to implement them by the end of the year."

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Iris Hagdorn, Head of Sustainability
Warburg-HIH Invest

About Warburg-HIH Invest

Warburg-HIH Invest is one of the leading investment managers for real estate in Germany and Europe. We adopt a future-oriented approach to finding, developing and managing properties in the interests of our clients.

Decades of experience, proximity to the real estate markets and a tight-knit network allow us to identify real estate opportunities and quickly implement them in the right phase of the market.

Around 150 institutional clients have entrusted their investments to Warburg-HIH Invest. Our specialists for structuring, product development, real estate management and market development all work to develop the right investment solutions for them.

Warburg-HIH Invest is represented at ten locations throughout Europe. As part of the HIH Group, our in-house capacities cover the entire real estate investment value chain.

Early identification of changes in the market, implementation of regulatory requirements and future-oriented digital management are part of our corporate philosophy.

We currently manage assets with a volume of more than EUR 12.9 billion across 78 funds.

More information can be found on the the company's website at: **www.warburg-hih.com/en**

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