Joint position paper on the EU taxonomy

The real estate sector plays a vital role in helping to achieve the EU's climate goals, as reducing carbon emissions makes a significant contribution towards mitigating climate change. Meaningful action to cut GHG emissions is crucial to transitioning the existing building stock onto a net zero pathway.

Banks also serve as key facilitators in this process as they can pave the way to a more carbon-friendly building stock by providing finance and creating incentives.

In launching the Green Deal and establishing the EU taxonomy, the European Commission laid the groundwork for channelling investment into environmentally friendly projects and achieving the EU's climate goals. While the broad direction of the EU taxonomy is laudable, we have significant reservations that the complex requirements may have the opposite effect and that the EU taxonomy inadequately addresses the transition of buildings to carbon neutrality.

In particular, the taxonomy poses the following five fundamental areas of concern for the financial and residential real estate sectors, which are described in greater detail on the following pages.

1 The primary energy requirements for new buildings have been set too high

2 The taxonomy is not sufficiently compatible with the EU Energy Performance of Buildings Directive (EPBD)

3 The costs for transitioning existing buildings to net zero have been underestimated

4 The Do No Significant Harm (DNSH) criteria are overly complex and unworkable in practice

5 The taxonomy fails to ensure a balance between sociocultural and environmental aspects

Both GdW and vdp believe that the following measures, in particular, could prove effective in ensuring the success of the EU taxonomy:

Recommendations:

1) Energy efficiency requirements should be limited to those for national “nearly zero-energy buildings” in order to enable the cost-effective construction of new buildings and affordable rented housing.

2) The taxonomy should be focused on renovating buildings with the worst overall energy efficiency performance, thereby aligning it with the EPBD that already takes a “worst-first” approach (see figure below).

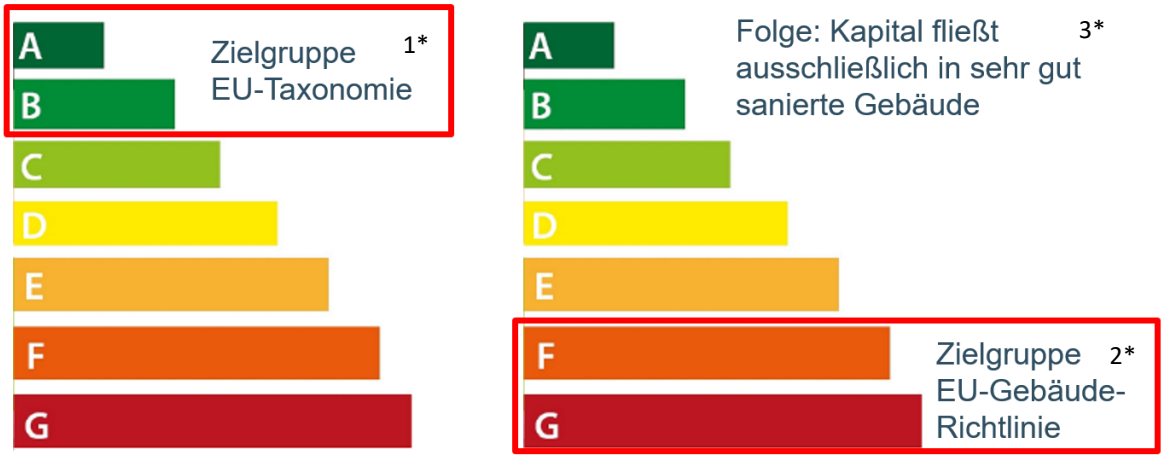

Figure: Conflicting objectives between EU taxonomy and EPBD

1* Target group in EU taxonomy
2* Target group in EPBD
3* Result: Capital only flows to buildings already renovated to a high standard

3) Buildings that have been renovated and achieve emission reductions along a defined net zero pathway should be classified as Taxonomy-aligned. This includes:

- The recognition of efficiency gains from renewable energy sources when existing buildings are renovated.
- Classifying the whole building and the entire financing as a Taxonomy-aligned economic activity in the case of energy efficient renovations if the taxonomy requirement for an energy efficient renovation is met.

4) The emphasis should be placed on carbon reduction targets, while significantly reducing the importance, number, complexity and assessment of DNSH criteria, for example by designating them as “monitoring criteria”.

5) The introduction of a mechanism to ensure a balance between environmental and social dimensions.

Explanatory remarks on areas of concern and recommendations

1. Aligning energy efficiency requirements with national measures for nearly zero-energy buildings ((EU) 2021/2139, Art. 7.7./7.1.)

Article 7.7 states that any building purchased that was built after 31 December 2020 only makes a significant contribution to mitigating climate change if it meets the criteria for new buildings specified in Article 7.1, i.e. if its Primary Energy Demand (PED) is at least 10 % lower than the threshold set for nearly zero-energy building (NZEB) requirements in national measures. **This arbitrary threshold impedes the affordable construction of new buildings**. In Germany, buildings constructed according to the GEG (Building Energy Act) are considered nearly zero-energy buildings. The Primary Energy Demand depends on the technical specifications of each building. **The EU taxonomy's strict energy efficiency requirements increase construction costs without any appreciable reduction in carbon emissions, while undermining national and European efforts to reduce the cost of construction and, in this way, contribute to increasing the supply of affordable housing.**

We call for energy efficiency requirements to be aligned with the national measures for nearly zero-energy buildings rather than exceeding them.

2. **Focusing the EU taxonomy on renovating buildings with the worst overall energy efficiency performance, aligning it with the EPBD that already takes a "worst-first" approach ((EU) 2021/2139, 7.2.)**

The taxonomy adopts a best-in-class approach in contrast to the EPBD's worst-first approach to promoting the transformation and renovation of the existing building stock. The EPBD rightly prioritises the renovation of buildings with the worst energy efficiency performance. **The efficiency gains from renovating buildings with a poor energy efficiency performance are considerably higher than renovating those that already have a good energy efficiency rating. However, the current focus of the EU taxonomy on the best-performing buildings ("best-in-class") undermines this "worst-first" approach.**

To ensure consistency in the necessary transformation of the building stock, the taxonomy should be harmonised with the EPBD and adopt its worst-first principle to expedite energy efficiency gains, renovation and decarbonisation of the building stock. This could be achieved, for instance, by defining a building and its financing as Taxonomy-aligned if it meets EPBD requirements.

3. Classifying renovated buildings along a defined decarbonisation pathway that achieve reductions in carbon emissions as Taxonomy-aligned ((EU) 2021/2139, 7.2.)

The taxonomy does not acknowledge the transformation pathway of buildings to net zero if they do not adhere to the strict taxonomy criteria. This means that existing buildings transitioning to carbon neutrality are disadvantaged, as the only renovation measures that are considered Taxonomy-aligned are those that reduce the Primary Energy Demand by at least 30 %. In particular, partially modernised buildings with medium energy efficiency ratings are no longer able to achieve a 30 % reduction in energy demand. What about buildings that have already been renovated to achieve a 20 % reduction in PED and achieve emissions reductions on a net zero pathway? What about buildings that have already been renovated to achieve a 20 % reduction in PED and have reached carbon neutrality? **In future, this**

regulatory approach may give rise to significant disadvantages in financing buildings that are non-Taxonomy aligned despite being on a transformation pathway to net zero carbon emissions.

For this reason, all buildings that achieve carbon emission reductions along a climate mitigation pathway should also be classified as Taxonomy-aligned.

- **The recognition of efficiency gains from renewable energy when existing buildings are renovated ((EU) 2021/2139, 7.2)**

According to Article 7.2, efficiency gains from renewable energy sources may not be considered when buildings undergo energy efficient renovations. For example, installing a photovoltaic system is not currently eligible to count towards the required 30 % reduction in Primary Energy Demand. However, it is exceptionally difficult, if not impossible, to separate efficiency gains from renewable energy sources from those achieved (and recognised) in other ways. Furthermore, it is likely that the respective efficiency gains can only be determined after the loan has been granted (e.g. by conducting before and after EPC assessments). However, for the financing to be Taxonomy-aligned, efficiency gains must be demonstrated at the same time the loan application is submitted.

Consequently, efficiency gains from renewable energy sources when existing buildings are renovated must be recognised by amending footnote 299 of the Commission Delegated Regulation (EU) 2021/2139.

- **Classifying the entire building and the whole loan as a Taxonomy-aligned economic activity in the case of energy efficient renovations if the taxonomy requirement for an energy efficient renovation is met ((EU) 2021/2139, 7.2.)**

When the purchase and renovation of a property are financed together, the taxonomy states that only the part of the loan (used to finance the renovation) counts as the Taxonomy-aligned economic activity of "renovation of existing buildings" (Article 7.2). In many cases, the purchase and renovation of a building are jointly financed, with the portion of the finance for renovation only making up a small part of the loan. Frequently, however, renovation work does not result in the building achieving energy efficiency class A or being among the top 15 % of the existing building stock. Consequently, following the renovation the building does not meet the relevant taxonomy criteria for the acquisition and ownership of buildings. For this reason, only a minor portion of many loans qualifies as Taxonomy-aligned under the economic activity of "renovation of existing buildings".

We call for the Delegated Act to be amended in such a way that it recognises the entire building or loan as Taxonomy-aligned for the economic activity of "renovation of existing buildings" if it meets the taxonomy requirement for an energy efficient renovation.

4. Emphasis on carbon reduction targets, significant reduction in importance, number, complexity and assessment of DNSH criteria, for example by designating them as “monitoring criteria” ((EU) 2021/2139, Art. 7.1./7.2.)

According to the EU taxonomy for sustainable activities, failure to comply with even a single DNSH criterion renders the entire economic activity non-Taxonomy aligned. Consider this case: A new building is carbon neutral, but because its plumbing system includes fixtures that exceed thresholds defined in the DNSH requirement for the “sustainable use and protection of water and marine resources,” the building and its financing are not considered sustainable within the meaning of the taxonomy.

The TSC and DNSH criteria lack sufficient proportionality in their application. A complex process of assessment must be conducted even for small loans and microlending to consumers - a barely feasible undertaking, particularly in the low-margin retail segment. In FAQ 170 of the taxonomy, the EU Commission argues that it is necessary to conduct a Climate Risk and Vulnerability Assessment even when installing new windows in an office building.

Regardless of how relevant the DNSH criteria may be, the number of requirements is too high and the assessment and documentation of DNSH criteria for the "construction of new buildings" and the "renovation of existing buildings" too complex. The assessment process is extremely cumbersome, especially due to a lack of relevant data. As a result, this frequently prevents an activity from being Taxonomy-aligned while failure to comply with DNSH criteria may lead to less favourable financing conditions.

Taken together, the complex and strict "Do No Significant Harm" (DNSH) criteria jeopardise the transformation of the building stock to net zero carbon emissions as they are incompatible with a taxonomy alignment and incur significant additional costs that have a direct impact on the affordability of housing. **The strict requirements must not result in tenants having to shoulder additional expenses due to the higher cost of renovation. This risks undermining acceptance in society of the principle of the transition to climate neutrality.**

In order to focus on climate goals, the DNSH criteria must be designated as "monitoring criteria" to ensure that non-compliance does not automatically mean that an economic activity is non-Taxonomy aligned. Furthermore, we propose a significant reduction in the number of requirements as well as the complexity of the assessment process and documentation associated with the DNSH criteria for the "construction of new buildings" and the "renovation of existing buildings".

Alternatively, if an activity does not meet any of the DNSH criteria, this could be compensated for by a mechanism to ensure a fair and equitable cost burden sharing (see point 5) that would take account of the need to reconcile the environmental and socio-cultural aspects of sustainability.

5. The introduction of a mechanism to ensure sociocultural aspects are factored into the taxonomy's environmental criteria

Ultimately, it is vital to ensure a balance between the environmental and social dimensions of sustainability within the framework of the taxonomy. The current requirements fall short of achieving this. **The result is that environmental criteria take precedence at the expense of key social aspects**. As such, mechanisms should be introduced that take account of sociocultural aspects as part of the taxonomy's environmental criteria. These could include criteria such as the level of rents, the quality of the neighbourhood, community-related aspects, liveability, safety and security and community facilities.