New Normal – the future of the real estate industry

WebCast 10th February 2021 10:00 – 11:00 Uhr

Kicking off the ESG year 2021! – industry reactions from different perspectives

- Regulatory framework – Overview of basic principles
- ESG impact in Valuation – Assessing ESG risks
- ESG impact in Transaction – ESG due diligence a necessary amendment?
- Legal perspective – adapting ESG in contracts?
- Tax perspective – initiatives to take ESG into tax consideration

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Updates and Informationen: https://blogs.pwc.de/real-estate/
2021 has ESG in its focus - not only literary!

**Convincing with action as motto of the hour!**

- **David Attenborough** – writer, wildlife filmmaker and naturalist, now 94 years old
- His latest book "A life on our Planet" deals with the negative transformation of global biodiversity within the last decades
- **Proclaimed theses** (among others): protect biodiversity, stop deforestation, start rapid reforestation (especially of rainforests), limit fishing locally
- **Nature is more resilient than human beings** – after man-made environmental destruction (e.g. Chernobyl), nature always fights its way back!
- **Time to act is now** – it is not too late, species extinction and climate change can still be stopped and biodiversity protected, but this requires global action! Now!
- **Pressure** on people must continue to grow and be politically moderated to get the necessary climate-friendly behavior. This is especially true for the real estate sector (we spend 87% of our lives in real estate!)
The regulatory framework for sustainable financial products has become more precise

Overview of the regulatory framework for 2021

- Disclosure Regulation (EU) 2019/2088 enters partial scope of application on 10 March 2021 – Financial market participants and financial advisors must disclose the characteristics of the fund product and the handling of sustainability risks in the investment process.

- The Taxonomy Regulation (EU) 2020/852 defines criteria for sustainable investments and also disclosure obligations as of 1 January 2022.

- The BaFin leaflet on dealing with sustainability risks for financial market participants according to KAGB and KWG implicitly unfolds its applicability and sustainability risks should be integrated into the existing risk management processes.

- At the European level, the EBA has specified guidelines for the requirements of risk management and the handling of sustainability risks.

- Further adjustments to existing regulations (Solvency II, IDD, MiFID II, AIFMD) will probably take place in 2021.
Requirements to ensure compliance with 10 March 2021

Necessary implementations until 10 March 2021

Adaptation of the financial market participant’s website

- Publish **up-to-date information on their strategies** for incorporating **sustainability risks** into their **investment processes**
- Overview of **adverse sustainability impacts** as a description (if a declaration is provided, otherwise negative declaration).

Adaptation of the customer documents of the financial product

- **Adaptation** of the **pre-contractual documents** (sales prospectuses or 307 documents for fund investors) and inclusion of how and in what way sustainability risks are included in investment processes
- Inclusion in the description of the **investment strategy** of the **financial product** if **ecological or social features** are advertised, the **product** is intended to **promote** them or is associated with them.
Further regulatory requirements are on the horizon

Timeline for 2021 and 2022

10th of March 2021
- Application OV Level 1 – Adaptation website and pre-contractual information
- Possible publications of further regulatory requirements Level 2 (Taxonomy Regulation, Disclosure Regulation, AIFMD, MiFID II, IDD & Solvency II)

March/April 2021

1st of January 2022
- Application of the Taxonomy Regulation – Disclosures on financial products (climate protection and adaptation to climate change)
- Planned application of OV Level 2 RTS - Adaptation of website and pre-contractual information according to RTS in detail

From 1st of January 2022*
- Application OV Level 1 – Adjustment of regular reports

*As part of the annual reporting - depending on the reporting date (1 January 2022 at the earliest)
Capital markets prices ESG risks, this is also valid for the Real Estate Industry

A PwC study shows clear valuation advantages

• As part of a comprehensive study, various industries were first examined with regards to market capitalization and ESG ratings on the basis of capital market data and three categories were formed:

1) Leader (leading track record in managing ESG risks and opportunities in its' industry)

2) Average (average track record)

3) Laggard (lagging behind)

• Across all industries, the capital market usually shows a higher market capitalization for leaders and average than for laggards.

• Thus, the capital market is already is pricing ESG compliance and non-compliance; also for the real estate sector

PwC Enterprise valuation (VMA)
The regulatory framework is specified and getting concretely

**EU taxonomy and market perspective**

- **Specifications for the real estate industry** (draft):
  1) New construction
  2) Comprehensive refurbishment / modernization
  3) Renovation
  4) Acquisition and ownership

- Following the requirements and the market reactions that properties which are not **taxonomy-compatible** are subject to **restrictions** with regards to investors, users and management

- Keyword: **Non-eligibility** for sustainable economic activity according to taxonomy

**Energy paths for real estate – the Netherlands**

- **In 2016**, it was determined that **office buildings** with energy labels **worse than C** may no longer be **operated** from 2023 (impetus for refurbishment; at the time approx. 2/3 of the stock)
ESG in context of the valuation of real estate assets

Capital markets

• Companies in the real estate sector that are leaders in the consideration and management of ESG are valued higher by the capital market

• Gaps between leaders and laggards are likely to widen due to stricter regulation

Regulatory and market perspective

• Requirements for both new construction and existing buildings from taxonomy, etc. require adaptability of properties

• Non-consideration leads to restrictions for potential investors, users and management.

• Worst case: prohibition of use (cf. Netherlands)
Aim of the ESG due diligence

Advantages
- Better financing conditions
- Higher expected returns
- Better reputation
- PwC ESG Tool for standardized ESG due diligence

Challenges
- Data acquisition by property or asset manager
- Evaluation not yet standardised
- Gaps in data, especially for existing properties
- Creation of incentives for tenants to participate in ongoing ESG compliance (e.g. rent-free time as a reward)

What may / must I do?
- Fulfilment of the regulatory requirement for me as a company
- How ESG-compliant should my corporate strategy be?
- How do I want to be perceived in the market?
- Which market participants / investors do I want to generate as customers?
Operationalisation

What do you examine in a ESG due diligence?

- **Governance**
  - Are stakeholders behaving properly?
  - Avoiding corruption

- **Social**
  - How does the building fit into the environment?
  - Connection to public transport

- **Environmental**
  - What are the ecological features of the building?
  - Energy certificate Certification

- **Operationallisation**
  - Checking the right things at the right time.

- **External support**
  - Get the relevant experts on board

- **Result**
  - Making a conscious investment decision?
  - Does the asset fit my strategy?

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**Environmental objectives**

1. Climate change mitigation
2. Climate change adaptation
3. Sustainable use and protection of water and marine sources
4. Transition to a circular economy, waste prevention and recycling
5. Pollution prevention and control
6. Protection of healthy ecosystems

- Substantially contribute to at least one environmental objective
- Do no significant harm to any other five objectives
- Comply with minimum safeguards

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Contracts: Quick wins possible in the creation, implementation and further development of the ESG strategy

**Data model & measurement concept**
- Regulations on the collection and exchange of ESG data in all real estate-related contracts as a central component of an ESG strategy (incl. model clauses)
- **Requirement**: Compliance with data protection regulations and protection of business secrets

**Flexible contract design**
- Ensuring the adaptation of continuing obligations to changing conditions (market / regulatory)
- Opening clauses for implementation and adjustments of ESG strategies
- Individual clauses for certification standards

**ESG Targets & Risk Management**
- Changed due diligence and risk management processes with regard to ESG risks
- Tightening of minimum standards on labour, environmental protection and anti-corruption etc

**ESG Goals & Stakeholder Management**
- Agreement on mandatory sustainability criteria
- Creating healthier, environmentally friendly living, housing and / or working spaces
- Life cycle consideration
- Securing patents and copyrights

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**Independent of ESG strategy**
- Regulations on the collection and exchange of ESG data in all real estate-related contracts as a central component of an ESG strategy (incl. model clauses)
- **Requirement**: Compliance with data protection regulations and protection of business secrets

**Depending on ESG strategy**
- Requirements: Compliance with data protection regulations and protection of business secrets
Legal framework

ESG criteria in green leases

- Requirements from EU taxonomy with particular impact on leases (Green Lease)
- EU regulation as a driver of **far-reaching changes**
  - Regulatory areas of ESG green leases
  - Data exchange regulations
  - Digital control devices
  - Opening clauses
  - Energy monitoring and management
  - Compliance and governance
- **Declarations** of intent vs. hard/soft commitments
- **Opportunity and risk at the same time:** effectiveness problems of individual contractual provisions
- Integration into the **text of the contract** or as independent **sustainability annex(es)**

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Increasing importance of ESG Tax

Tax and Sustainability – ESG Tax

- Taxes serve to finance the state
- Realization of the 17 UN Sustainable Development Goals also through tax payments
- Conflict of goals: minimizing tax payments from the company’s perspective (taxes are costs) and maximizing the sustainability efforts of states and financing through tax revenues

Outstanding significance of GRI 207 – Tax 2019 – Tax sustainability reporting

- Combining a company’s tax policy with fiscal transparency, sustainability and responsible business practices
- Sustainable taxation and adaptation of internal processes
- Fiscal transparency as an enabler for material sustainability

ESG Tax Strategy

- Definition and description of a company’s tax policy and tax strategy
- Company’s position on tax morality and tax transparency
- Responsible tax practices consistent with the company’s Global Code of Conduct

ESG Tax Framework

I
- BEPS action plan 13
  • 13 Country-by-Country Reporting (CbCR)

II
- BEPS action plan 12 and DAC6
  • Reporting obligations for cross-border tax arrangements

III
- ATAD and ATAD2
  • a.o. hybrid designs

IV
- Global Reporting Initiative
  GRI 207 – Tax 2019
  • Disclosure 207-1: Approach to tax
  • Disclosure 207-2: Tax governance, control and risk management
  • Disclosure 207-3: Stakeholder engagement & management of concerns related to tax
  • Disclosure 207-4: Country-by-country reporting
GRI 207 – Tax 2019

- Publication on 5.12.2019, applicable to reports published on or after 1.1.2021
- Reporting on tax topics in four regulatory areas (disclosures)

**Disclosure 207-1**

**Tax concept**
- A company's general approach to the topic of taxation
- In particular, the company must describe its tax strategy and how it is linked to the company's sustainability strategy

**Disclosure 207-2**

**Tax administration, control and risk management**
- Internal company processes and controls relating to taxes
- Group-wide TCMS
- Tax risk management processes
  - Tax compliance management processes

**Disclosure 207-3**

**Stakeholder engagement and management of fiscal concerns**
- Representing the interests of the company externally and taking into account the interests of stakeholders internally.
- Cooperation with tax authorities, political influence on tax issues, dealing with stakeholder concerns

**Disclosure 207-4**

**Country-by-Country Reporting**
- Similar to Action Item 13 of the OECD BEPS project.
- Disclose a variety of information for all tax jurisdictions in which a company operates, including principal activity, number of employees, employee compensation, profit before tax, income taxes owed and paid, and reasons for differences

- Publication on 5.12.2019, applicable to reports published on or after 1.1.2021
- Reporting on tax topics in four regulatory areas (disclosures)
Tax Services in the area of sustainability – ESG

Creation of Tax Sustainability Reports

- **Basis:** Standard GRI 207 – Tax 2019
- Support in the preparation of a **GRI report** and separate evaluation of the **CbCR data** by means of **dashboards**
- Development of a **communication strategy**
- **Best practice consulting/process optimization** for better GRI performance Consulting/creation of tax strategy/analysis of significance for the capital market

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Your questions to the PwC experts

- Regulatory framework
- Impact Valuation
- Impact Transaction
- Legal perspective
- Tax perspective
PwC information about the New Normal and its impact on the real estate industry can be found here:

News on the subject of real estate also in the context of New Normal
https://blogs.pwc.de/real-estate/
www.pwc.de/de/real-estate/pwcs-real-estate-institute.html
https://www.pwc.de/real-estate.html

Email address for questions to PwC experts on the subject of New Normal
decovid19_pwc_real_estate@pwc.com

PwC Plus – Information about real assets with push message function
https://pwcplus.de/

Fortnightly expert session via WebCast on current topics
Wednesday 10:00 to 11:00
The new normal – the future of the real estate industry

Next session on 24th of February from 10:00 am

Current developments in Real Estate!

Registration via Link: www.pwc-events.com/Real-Estate-WebCast