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Valuation in the wake of the European Green Deal

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Massive and pervasive EU environmental law impacts land and buildings

- Energy efficiency
- Renewable energy
- Rooftop solar energy installations
- The greening of parking areas with smart electric charging and mandatory bicycle space
- Legislation on air, water and soil
- The greening of construction materials and technical building systems
- Buildings in the circular economy
- EU taxonomy
- Green mortgages
- and financial institutions' and other industries' ESG obligations

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How is the valuer to distinguish and prioritise all this?

One way is by applying certain criteria to each of those EU laws:

- The degree of coercion of the law
- Its identifiable impact on real estate markets
- And the scale and speed of impact

Taken together, they lead to a two-tier approach*, because there is a fundamental difference between the latest Green Deal energy efficiency legislation and all the rest.*

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The two-tier valuation approach

First tier: Energy efficiency. *Direct and rapid impact on markets and values*

The Green Deal legislative package has several laws impacting buildings including the very important extension of the EU ETS to buildings, but two of them – by accelerating the speed and depth of renovation across Europe – have direct and rapid impact:

1. The Energy Efficiency Directive

2. The Energy Performance of Buildings Directive

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(Gníomhartha reachtacha)

TREORACHA

TREOIR (AE) 2023/1791 Ó PHARLAIMINT NA hEORPA AGUS ÓN gCOMHAIRLE

an 13 Meán Fómhair 2023

maidir le héifeachtúlacht fuinnimh agus lena leasaítear Rialachán (AE) 2023/955 (athmhúnlú)

(Téacs atá ábhartha maidir le LEE)

The European Group of Valuers' Associations

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It’s a done deal

Published in the Official Journal of the EU:

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Directive (EU) 2023/1791 of the European Parliament and of the Council of 13 September 2023 on energy efficiency and amending Regulation (EU) 2023/955 (recast)

Deadline for transposition into national law: 11 October 2025

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Directive (EU) 2023/1791 on energy efficiency

Exemplary role of public bodies' buildings

Existing Directive

3% of buildings owned and occupied by central government must be renovated each year to the level of the minimum energy performance requirements of the EPBD.

Revised Directive

3% of buildings owned by public bodies must be renovated each year to nearly-zero energy building (NZEB) level.

NB: *Buildings that escape the 3% cull in any year don't get off scot-free; they fall under the requirements of the Energy Performance of Buildings Directive*

Energy Efficiency Directive
Exemplary role of public bodies' buildings

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Existing Directive

Buildings rented by government from private sector landlords:

Nothing

Revised Directive

Buildings rented by government from private sector landlords:

"Where public bodies occupy a building that they do not own, they shall negotiate with the owner, in particular when reaching a ***trigger point*** such as renewal of rental, change of use, significant repair or maintenance work, with the aim of establishing contractual clauses for the building to become a nearly zero-energy building."

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Energy Performance of Buildings Directive

New buildings

Existing Directive

Since 2021*, all new buildings have had to be ***near-zero energy buildings*** (NZEB).

** The Directive dates from 2018, but the obligation only kicked in as of 01.01.2021.*

Revised Directive

All new buildings to be ***zero-emission***

Deadlines still under discussion:

Parliament:

- New public buildings: 2026
- All new buildings: 2028

Council:

- New public buildings: 2028
- All new buildings: 2030

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EPBD: *Existing Buildings*

Minimum Energy Performance Standards (MEPS)

Existing Directive

The renovation obligation only kicks in when the owner freely decides to do a major renovation.

Revised Directive

Obligation on Member States to raise entire segments of the building stock to higher energy performance certificate (EPC) classes within five to ten years.

Concerns buildings both public and private, commercial and residential.

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EPBD: Rooftop solar installation

An ‘extra’ introduced by the Commission in May 2022, five months after the Directive was tabled:

Mandatory rooftop solar installation by end 2026 (new public and non-residential), **end 2027** (existing public and non-residential) **or end 2029** (new residential).

The only real estate exempted is:

- Existing residential
- Public and commercial buildings smaller than 250 m^2 or with low solar potential (limited access to light, etc.)

This comes with further EU regulation limiting the length of **permitting** for rooftop solar installations, including large ones, to a **maximum of three months**.

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This is the market-changing regulation

There will be no ‘ifs’ or ‘buts’; hard EU law dictates how and by when the job will have to be done and ***it will concern millions of homes, offices and shops*** at the same time.

This will finally break the deadlock of the secular annual renovation rate of 1 to 2% of the national building stock.

Valuers will not have the luxury of waiting and seeing. They will have to estimate the impact on market value of a building having to be renovated or, if it isn’t renovated, not being sellable or rentable by a certain date and they will be helped in this by the rapid emergence of numerous comparables.

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That is why the far-sighted EVS 2020 laid down ground rules for energy efficiency valuation

And that's why it took the form of the first new Standard in many decades:

European Valuation Standard 6 Valuation and Energy Efficiency

That was no easy thing. Many people hesitated to put an energy efficiency requirement in *binding Standards* which have always been restricted to the basics of the profession: bases of value, the qualified valuer, the valuation report.

But – like Luca Bertalot with his green mortgages long before anybody was interested – TEGOVA saw the future.

Second tier: The gradual valuation impacts of sustainability issues and ESG

On the other hand, the other EU Green Deal legislation is neither as coercive, as identifiable and quantifiable, nor as immediate in its effect as the energy efficiency laws.

For example, **construction products** will indeed have to be greener, more circular. But on the ground that will be a very gradual process and how is a valuer supposed to identify that and integrate it into the determination of market value?

Or again, **the draft Soil Monitoring and Resilience Directive**, by increasing the identification of contaminated sites, may enable the valuer to do more with contaminated sites than just stick them in the Disclaimer. …

Someday. Eventually. Maybe.

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ESG

Under EU law, corporations have reporting obligations covering:

- Not just a wide spectrum of climate, pollution, water, biodiversity and circular economy issues (E),
- But also worker and consumer issues (S)
- And business conduct (G).

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Although if you look closely at the detail, there seems to be a lot of 'E' and precious little 'S' and 'G'

For instance, under the revised Capital Requirements Regulation, ***banks will be required to report information on their exposures to ESG risks*** as part of the supervisory reporting framework.

But if you look at the *ECB Guide on climate-related and environmental risks - Supervisory expectations relating to risk management and disclosure* it seems to be all about 'E' or "climate-related risks" and in fact even that seems to be all about measuring the carbon intensity of large corporate portfolios and ***the property-by-property measurement of actual energy consumption or energy efficiency classification for real estate portfolios***.

And there we go: back to good old energy efficiency and EPCs.

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And yet, EU sustainability law is more complex than just CRR because you also have:

The Corporate Sustainability Reporting Directive (CSRD) puts sustainability reporting at the same level as financial reporting notably in companies' annual reports. On 9 June, the draft of the first set of CSRD European Sustainability Reporting Standards (ESRS) **covered: 'E', 'S' and 'G'.** The 'S' was workers and consumers and the 'G' was business conduct.

The Sustainable Financial Disclosures Regulation (SFDR) improves transparency on sustainable investment products and sustainability claims made by financial market participants. Amending Delegated Acts on fiduciary duties, investment and insurance advice ensure that financial firm professionals (e.g. advisers, asset managers or insurers) include sustainability in their procedures and their investment advice to clients.

The Proposal for a Corporate Sustainability Due Diligence Directive (CSDDD) lays down obligations for companies to carry out due diligence to identify and address human rights and environmental adverse impacts, and to produce climate plans.

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Given all that, it's no big surprise that, for instance, international banks in Portugal are asking their valuers to cover risks of:

- Floods
- Landslides
- Dam bursts
- Coastal erosion
- Heat waves
- Fires
- Earthquakes
- Tsunamis
- Hazardous materials
- Pollution/contamination

As well as, of course:

- Energy efficiency
- and ESG!

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Now you tell me …

Even if clients actually were willing to pay extra, **how are valuers supposed to make enough sense of all that soup to integrate it into their determination of market value?**

This smells of Greenwash … bigtime!

You all know how it'll be done: the tick-box bank valuation report lists all the items to be covered and the valuer is expected to sign off that he took it all into account in the estimation of value.

Let's not even think about the potential valuer liability aspects of this.

Meanwhile, confusing and divergent implementation of EU ESG requirements has already caused such a business and political backlash …

… that the European Commission had to publish a Proposal for a Regulation on the transparency and integrity of ESG rating activities for preventing conflicts of interest and having ESG ratings providers authorised and supervised by ESMA (European Securities and Markets Authority) to protect investors and market integrity.

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And what's more …

"The Commission is conducting **a study to assess the current state of play of the social dimension of ESG investing** in the EU, focusing on investment gaps, challenges faced by market participants and market practices. The study will explore ways to strengthen the social investment framework in capital markets, identifying obstacles and possible policy options for future action."

*Commission Communication "A sustainable finance framework **that works on the ground**"*, footnote 35, p. 8

That's the Commission's diplomatic and politically correct way of stating that it has serious issues with 'S' and that it's taking action.

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And finally, the Commission:

- announced the tabling of legislation in 2024 ***postponing the Accounting Directive's sustainability reporting standards*** burden by two years
- announced further legislation adjusting the thresholds for the application of the Accounting Directive to ***spare one million companies from the reporting requirements***
- started exploring ways of ***keeping large companies' sustainability reporting standards from 'trickling down' to the smaller companies*** servicing them (potentially valid for valuers servicing banks)

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“Environmental, social and governance scores measure everything. Consequently, they measure nothing.”

Aswath Damodaran, professor of finance at the Stern School of Business at New York University

Financial Times of 25 October 2023

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But that doesn't mean that wider sustainability issues are irrelevant to valuation, quite the contrary.

Diverse sustainability factors going well beyond energy efficiency are *gradually* generating public consciousness of sustainability-induced investment risks and opportunities that most definitely impact perceptions of value.

Valuers need to recognise that and bring it to the attention of their clients.

But the folly is to pretend that valuers can get a handle on all these complex issues in the context of a standard valuation report, a fortiori if it's paid at the same price as a standard report.

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EVS 2025 will take account of this duality in its two-tier approach

European Valuation *Standard* 6 "Valuation and Energy Efficiency" – which already *requires* our 70 000 valuers to take account of energy efficiency regulatory constraints is being tweaked in the Standard itself and also ***enhanced with Commentary providing more detail on exactly how to do this in a meaningful and time- and cost-effective way***.

And **EVS Part III Valuation and Sustainability** is being adapted to cover and *explain* all the new EU sustainability and ESG rules so that valuers have the *culture* to apprehend the wider regulatory and market phenomena gradually transforming real estate markets and values.

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