



**ESG (Environmental, Social
and Governance)
in Real Estate Investment**

A. ESG

Environmental, Social and Governance

Sustainability and social responsibility are becoming more and more important criteria for today's investments.

To make the sustainability and/or social impact of an investment measurable, aspects often summarized the terms ESG (environmental, social and governance), “responsible investment” or “social impact investing” are used. ESG criteria are utilized not only for the standard analysis of an investment's risks and performance prospects but also to assess whether an investment lives up to the social goals pursued by an investment strategy.

There is an observable trend of investors increasingly pursuing investment strategies which place more emphasis on E(nvironmental) and S(ocial) criteria and which exceed the requirements of the applicable standards in these areas by a wide margin. This is in reaction to the increased demand for (socially) responsible investments as well as trends in the market towards intelligent and reliable supply of cities and buildings with renewable energy and a higher quality-of-life standard in new urban development facilitated by using smart technologies.¹

¹ Noerr: Smart Cities Study – Success factors, ambient conditions and challenges for business models in the city of the future; 2021, [smartcities.noerr.com](https://www.smartcities.noerr.com).

B. Legal sources and standards

ESG criteria were first codified in 2015 by the United Nations in its Sustainable Development Goals (“SDGs”), which include the following sustainability goals² relevant to real estate:

- No. 1 – **No poverty** (affordable housing, access to a good residential location)
- No. 7 – **Affordable and clean energy** (sustainable buildings and supply of heat and electricity)
- No. 10 – **Reduced inequalities** (affordable housing, equal opportunity)
- No. 11 – **Sustainable cities and communities** (affordable housing, sustainable neighbourhoods and buildings)

- No. 12 – **Sustainable consumption and production** (sustainable buildings and construction materials, recycling, disposal)
- No. 13 – **Measures for Climate protection** (sustainable buildings, energy efficiency, electrification)

Recently, European legislators have also launched several initiatives to address ESG criteria. The core initiative is the EU Commission’s “European Green Deal”, a concept with the goal of reducing the net emission of greenhouse gases in the EU to zero by 2050.³

² Relevance of the sustainability goals to real estate according to “Social Impact Investing – The Best Practice Guide for the Real Estate Industry” published by the Institute for Corporate Governance in the German Real Estate Industry, February 2021, p. 37.

³ Communication from the Commission to the European Parliament, the European Council, the European economic and social Committee and the Committee of the regions – Brussels 11 December 2019 – The European Green Deal.

B. Legal sources and standards

Furthermore, under the EU Disclosure Regulation⁴, financial services providers must disclose sustainability aspects of their strategies, processes and products.

In the EU Taxonomy Regulation⁵, the European legislator has laid down the criteria as to exactly what is to be classified as environmentally sustainable. Both regulations are “Acts of general validity and direct effect in the Member States”, which means that no transposition into national law is necessary.⁶

The ICG (Institute for Corporate Governance) in the Real Estate Industry recently summarised an adaptation of social impact investing principles in a best practice guide for the real estate industry.⁷ Additional first steps have been taken towards creating ESG criteria specifically for the real estate industry for assessing the sustainability of properties and portfolios. In this context special mention should be made of ECORE’s (ESG Circle of Real Estate) scoring system for assessing the sustainability performance of properties and portfolios, an initiative launched by Union Investment and Bell Management Consultants consisting of more than 30 asset and property managers.⁸

4 Regulation (EU) 2019/2088 of the European Parliament and of the Council of 27 November 2019 on sustainability-related disclosures in the financial services sector.

5 Regulation (EU) 2020/852 of the European Parliament and of the Council of 18 June 2020 on the establishment of a framework to facilitate sustainable investment, and amending Regulation (EU) 2019/2088.

6 According to Art. 20(2) of the Disclosure Regulation, most of the provisions of this regulation have been in effect for relevant financial services providers since 10 March 2021, but the Taxonomy Regulation entered into effect on 12 July 2020.

7 “Social Impact Investing – The Best Practice Guide for the Real Estate Industry” published by the Institute for Corporate Governance in the German Real Estate Industry, February 2021

8 The scoring system of the ECORE (ESG Circle of Real Estate) for assessing the sustainability performance of properties and portfolios is expected to be published in May 2021.

The ESG score is to be determined¹⁰ based on the following clusters⁹ :

/ Cluster I: Governance

- Sustainability strategy and management
- External quality assurance
- Communication and raising awareness

/ Cluster II : Consumption and emissions (quantitative)

- Comparison of consumption data regarding type of use vs. benchmarks specific to climate zones
- Paris-ready: comparison to the German Federal Government's 2030 climate goals

/ Cluster III: Sustainable investment check (qualitative)

- Building automation
- Resources
- Exterior surface and technology
- Economy
- User convenience
- Operations
- Location

⁹ Weighting of the clusters: C I 20%, CII 40%, CIII 40%.

¹⁰ Bell Management Consultants, presentation: "ESG Circle of Real Estate – Gemeinsame Erarbeitung des neuen ESG-Scorings als Standard für den europäischen Immobilienmarkt" ("Working together to develop the new ESG scoring as a standard for the European Real Estate Market"), Mai 2020; the clusters do not constitute a division into ESG.

C. ESG in Real Estate

Early indications are that ESG criteria will play a (pivotal) role at various stages of the real estate investment cycle:¹¹



¹¹ See also the website of the initiative “Principles for Responsible Investment” (<https://www.unpri.org/>). PRI is an investors’ initiative partnering with the UNEP Finance Initiative and the UN Global Compact.

C. ESG in Real Estate

1. Deal Sourcing

For the decision whether a property is suitable for investment, ESG criteria (e.g. required share of subsidised housing, environmental certificates, energy efficiency class, reputational risks, etc.) can already be deal breakers (ESG-compliant investment). Due to their increasing significance, ESG criteria will play a more significant role in (legal) due diligence, and project developments will have to adjust to the fact that they will be evaluated on whether and which ESG criteria they meet.

2. Investment decision

Thus, the ESG criteria will likewise have (greater) impact on pricing, and it is to be assumed that they will become a standard component of each investment committees' decisions.

3. Holding periods

During the holding period of a property, (ESG) value generation measures, for example reducing and monitoring environmental impact, having the building certified and tenant involvement (instructions, information and participation) will become standard practice. In addition, asset managers will be chosen based on their ability to create such added value.

4. Exit

The continual monitoring and management of ESG factors will become a long-term factor in added value that will be reflected in the sale price achieved upon exit. The added value consists of not only the economic success but also the social responsibility that is assumed along with the property.

D. Our services

ESG-based advice from Noerr

With its interdisciplinary Real Estate Investment Group team, Noerr provides advice on all legal and tax issues involved in ESG-compliant real estate investments. We support you with services that include:

- development and implementation of an ESG strategy tailored to a specific company and/or product including individual governance and reporting structures for your company
- ESG-specific due diligence of properties and portfolios
- ESG-optimised structuring of your real estate investments
- structuring your real estate portfolio to make it ESG-compliant and implementing measures to improve the ESG score of the properties and portfolios you hold
- advice on statutory disclosure obligations under the Disclosure and Taxonomy Directives and disclosure obligations imposed in the future by national or European legislators

Your contacts

Our REIG experts look forward to hearing from you.



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Entrepreneurial Thinking

Noerr's advisors make their clients' challenges their own. They not only think along with them, but also ahead. In doing so, they are free in their decisions and take responsibility. Noerr's aim is to always go one step further for the client. And to solve complex issues with experience, excellence and a sense of proportion.

Innovative Solutions

In complex and dynamic markets new approaches are regularly required – and delivered by experts who bring both the know-how and the necessary passion. This is precisely what Noerr excels at: implementing integrated and innovative solutions in the most efficient way.

Global Reach

As one of the leading European law firms, Noerr is also internationally renowned. With offices in eleven countries and a global network of top-ranked “best friends” law firms, Noerr is able to offer its clients truly cross-border advice. In addition, Noerr is the exclusive member firm in Germany for Lex Mundi, the world's leading network of independent law firms with in-depth experience in 100+ countries worldwide.

Capacity in Central and Eastern Europe

Noerr has long had its own offices in all major Central and Eastern European capitals. The firm regularly advises on greenfield investments, joint ventures, acquisitions and divestments in Central and Eastern Europe by investors from all over the world. With more than 100 professionals, Noerr is one of the leading law firms in the region.

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