

Position Paper on the EU Taxonomy

Incentives for Energy-Efficient
Refurbishment of Existing
Buildings in Harmonisation
of Taxonomy and the
Energy Performance
of Buildings
Directive



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A. Summary

As part of its Green Deal strategy, the European Commission has set the goal of achieving climate neutrality in Europe by 2050. Already for the year 2030, the EU climate law provides a binding CO₂ reduction of at least 55 percent compared to 1991. The share of the building sector in Europe-wide CO₂ emissions is estimated at around 40 percent. In order to achieve the CO₂ reduction targets, considerable efforts must therefore be undertaken not only in new construction, but especially in the renovation of the existing building stock. This position paper lines out possible approaches how to trigger the necessary Renovation Wave.

Given its share in CO₂ emissions, a climate-friendly transformation can only succeed in cooperation with the real estate industry. The German Property Federation (ZfA) therefore strongly supports the ambitious and comprehensive efforts of the European Union to decarbonise the building sector, including the creation of appropriate conditions to help channelling private capital into sustainable investments. This applies in particular to the high level of ambition of the Taxonomy and the Energy Performance of Buildings Directive (EPBD) and its approach to prioritise the renovation of the worst buildings in terms of energy performance.

Investment Focus must be on the Refurbishment of Existing Properties

For a number of years now, high energy standards have been achieved in the construction of new buildings, which only have limited potential for further improvements. In contrast, the effect that can be achieved through the renovation of existing properties is much greater. However, this requires immense renovation efforts, which go hand in hand with considerable capital requirements for all parties involved. The goal must therefore be to create incentives for the energy-efficient refurbishment of existing properties and to ensure for a suitable investment environment.

Current Regulatory Environment leads to Capital Outflow

With the Sustainable Finance Action Plan launched in 2018 by the European Commission and the Taxonomy as its centre-piece, a legal framework has been set to channel private capital into sustainable investments. The Taxonomy created as a major tool to fight climate change has the pivotal function of defining criteria for sustainable economic activities and thus setting incentives for investments regarding decarbonisation. Whether it will actually be possible to mobilise the capital that is necessary for the renovation of the building stock depends on how the Taxonomy defines the sustainability criteria for the building sector.

In its current form, however, the Taxonomy is not suitable to channel sufficient private capital into the refurbishment of existing properties, as the very high ambition level of energy efficiency class A set out in the criteria can usually only be achieved in new construction. The reason is that the main focus of real estate investors is on increasing their Taxonomy quota, i. e. the ratio of Taxonomy-compliant properties to all properties in the portfolio. Investments in buildings that are not Taxonomy-compliant are avoided.

It is true that the Taxonomy also mentions the economic activity of renovation as a significant contribution to the sustainability goal of climate protection, provided that the primary energy demand (PED) of the building is reduced by 30 percent as a result. However, this cannot stimulate comprehensive refurbishment activity where it is most urgently needed. This is because, according to the “worst first” principle, properties in lower energy efficiency classes are to be refurbished as a matter of priority. However, a reduction of the primary energy demand (PED) by 30 percent, starting from level G or F, is by far not sufficient to achieve energy efficiency level A and thus Taxonomy compliance.

The inevitable consequence at present is that existing properties in lower energy classes, which urgently need to be refurbished, tend to be sold off rather than being renovated. On the contrary, investments are made in demolition and new construction to achieve Taxonomy-conformity. However, due to the additional consumption of resources and the “grey energy” contained in the building materials, this does not tend to serve climate protection and sustainability.

Ensuring an Appropriate Investment Environment for Refurbishment of Existing Buildings

With regard to viable investment conditions for the refurbishment of existing properties, two findings are of great importance:

- The worse the energy efficiency class of a property, the more favourable the cost-benefit ratio of refurbishment measures often is.
- The worse the energy efficiency class of a property, the greater the contribution of refurbishments to the avoidance of CO₂ emissions.

With the emphasis on the “worst first” approach in the EPBD, this enormous climate protection potential was also recognised by the EU legislator. However, necessary flanking measures in the Taxonomy, which create corresponding investment incentives to mobilise private capital, are still missing. This can be remedied in the Taxonomy by giving special rewards to renovations that are far beyond obligations (i. e. improvements in primary energy demand by considerably more than just 30 percent).

Proposal: Introduction of a Dynamic Taxonomy Component

ZIA specifically proposes to introduce another option in **economic activity 7.7. — Acquisition and ownership of buildings** in the Taxonomy as a significant contribution to the environmental sustainability goal of climate protection. This could promote investment in refurbishment of existing buildings by recognising properties as Taxonomy-compliant solely on the basis of a demonstrable reduction in their primary energy demand for a defined period of time. For the resulting refurbishment activity to be sufficiently efficient, the ambition level should be based on a reduction in primary energy demand of at least 50 percent compared to the building’s initial state before refurbishment.

B. Current Regulation and its Impact

The Energy Performance of Buildings Directive (EPBD) — “Worst First”

The Energy Performance of Buildings Directive (EPBD) sets high energy standards, which are expressed in the future requirement of zero emission buildings (ZEBs) for new construction and minimum energy performance standards (MEPS) for existing non-residential buildings.

The core approach of the EPBD is as follows: the greatest reduction in energy demand is achieved by first refurbishing the properties with the worst energy efficiency (“worst first” approach). Improving the energy efficiency from class G to F for example saves twice as much energy as refurbishing from efficiency class B to A.¹

In line with the “worst-first”-principle, the EPBD recast now sets the following requirements for the building stock:

- For non-residential buildings, minimum energy performance standards are to be introduced in each Member State. The corresponding threshold values in relation to

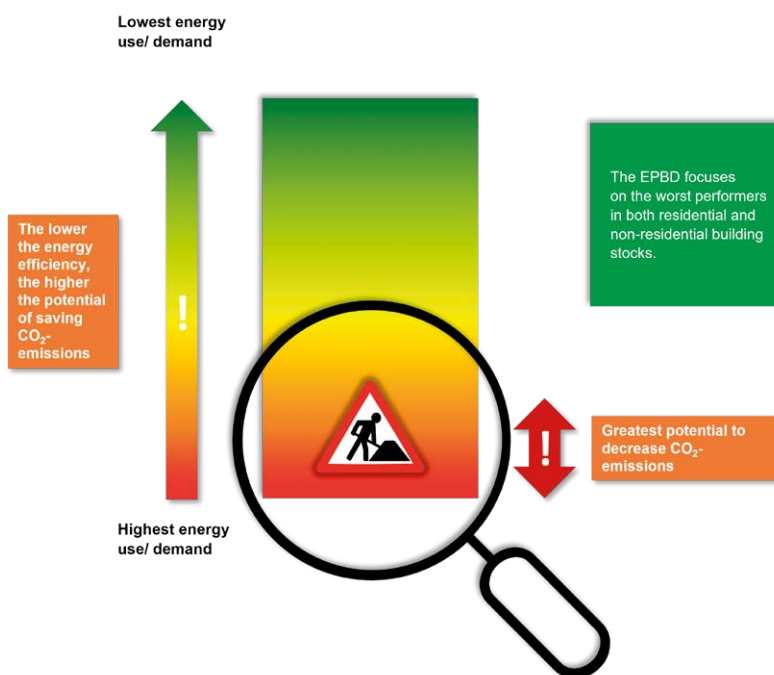
overall energy efficiency are to be defined in such a way that no more than 16% respectively 26% of the most inefficient buildings in the national stock are below this value. On this basis, all non-residential buildings must be above the 16% threshold from 2030 and above the 26% threshold from 2033 on.

- For residential buildings, national decarbonisation and renovation pathways are to be defined which ensure that the average primary energy consumption of the building stock of each Member State compared to the year 2020 is reduced.
 - by at least 16% by 2030 and
 - by at least 20–22% by 2035.

The aim is also to ensure that 55% of the reduction in average primary energy consumption is achieved by renovating the 43% worst buildings.

In accordance with the “worst first”-principle, the EPBD, unlike the Taxonomy Regulation, therefore focusses on those buildings which have the worst energy performance and prescribes their refurbishment within a clearly defined timeframe.

EPBD — The “Worst First” Approach



The idea behind the EPBD is that buildings in lower energy efficiency classes should be renovated primarily.

¹ Example for Germany: If the primary energy demand (PED) of a building is reduced from 250 kWh/m²a (lowest value of energy efficiency class G) to 200 kWh/m²a (lowest value of energy efficiency class F) through refurbishment, the reduction of the PED is 50 kWh. If the PED of a building is reduced from 75 kWh/m²a (lowest value of energy efficiency class B) to 50 kWh/m²a (lowest value of energy efficiency class A) through refurbishment, the reduction in PED is only half as large, at 25 kWh. The potential for reducing the PED is therefore considerably higher when improving the energy performance of buildings in lower energy performance classes than in well-rehabilitated buildings.

The Taxonomy Regulation – “Only the best”

The Taxonomy Regulation provides for a European framework since 18 June 2020, by which environmentally sustainable economic activities are defined uniformly throughout the EU. The Regulation is an important step towards achieving the overarching goal of a climate-neutral EU by 2050. In particular, it pursues the goal of empowering investors to channel their capital into environmentally sustainable activities and at the same time creates the obligation to disclose relevant turnover and investments of financial market players as well as large companies.

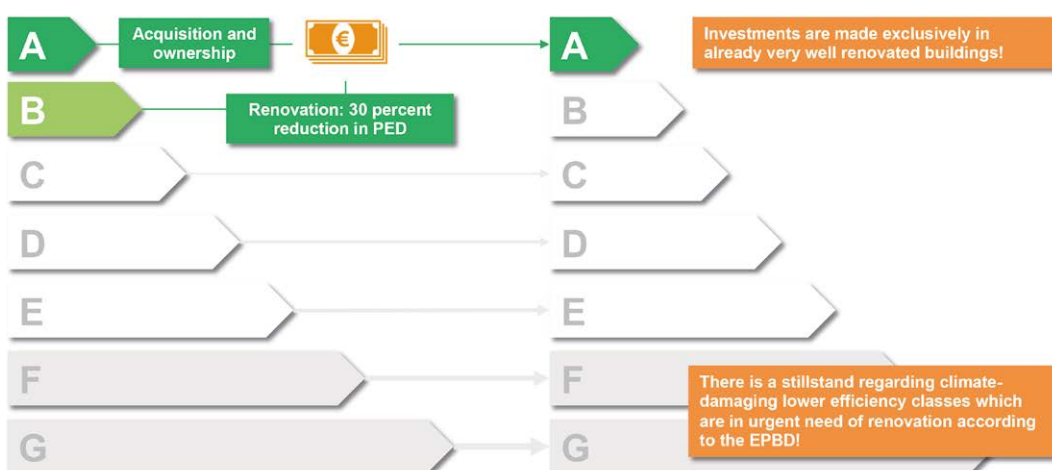
To achieve Taxonomy-compliance, an economic activity is required to make a significant contribution to one of six environmental sustainability goals², while not compromising any other sustainability goals (Do No Significant Harm) and, and, in addition, to meet minimum social standards³. In the real estate sector, Taxonomy compliance is usually achieved by making a significant contribution to climate protection.

In concrete terms, this means that in order to perform the economic activity of **Acquisition and ownership of buildings**⁴ (purchase of existing buildings) in a Taxonomy-compliant manner, the building must have a class A Energy Performance Certificate (EPC) or belong to the top 15 percent of the regional or national building stock in terms of its primary energy demand — a regulation that ZIA had strongly discussed in a constructive dialogue with the European institutions.

Furthermore, the economic activity **Renovation of existing buildings**⁵ is Taxonomy-compliant provided that the renovation makes a significant contribution to the sustainability goal of climate protection by leading to a reduction in primary energy demand of at least 30 percent. However, Taxonomy-conformity is limited to the renovation measure as such; the building itself will in many cases not reach Taxonomy-compliance even after the measure.

Taxonomy Regulation – “Only the best”

2024



2 The environmental sustainability goals will be referred to as sustainability goals for short in the rest of the text.

3 Since 4 June 2021, the first sustainability goals (1. climate protection, 2. adaptation to climate change) have been declared by the Delegated Regulation 2021/2139 of the European Commission of 4 June 2021. Since 5 April 2023, there has been a draft for a Delegated Environmental Regulation with the further sustainability goals (3. protection of water and marine resources, 4. transition to a circular economy, 5. prevention of environmental pollution, 6. protection and restoration of biodiversity and ecosystems).

4 Reference is made here to Article 7.7. Acquisition and ownership of buildings of Delegated Regulation 2021/2139.

5 Reference is made here to Article 7.2. Renovation of existing buildings of Delegated Regulation 2021/2139.

“Only the best” vs. “Worst First”: Taxonomy Regulation deprives Urgently Needed Sustainable Renovations of Investment Capital

Considering the enormous challenges of implementing the Renovation Wave, the primary goal of all efforts should be to direct available capital to where it can achieve the greatest effect. In relation to the refurbishment of the lowest energy efficiency classes, as much capital as possible should therefore be channelled into the refurbishment of the most energy-inefficient buildings in line with the “worst first”-principle. However, this is not mirrored by the current Taxonomy-design.

Consequence 1: Capital is preferably invested in new or very well refurbished buildings

Many property investors increasingly want to invest into Taxonomy-compliant properties, while they dispose of non-Taxonomy-compliant properties or shy away from new investments in properties in lower energy efficiency classes.

The consequence is that investments—in addition to new buildings—are preferably made in properties that already offer good conditions, e. g.

1. properties in efficiency class A that do not require further refurbishment because they are already Taxonomy-compliant and thus contribute to increasing the Taxonomy quota, or
2. properties with efficiency class B properties that can be upgraded to efficiency class A through minor renovations.

Consequence 2: Buildings in lower efficiency classes are more likely to be demolished than refurbished

Since many buildings in the worst efficiency classes cannot be refurbished to efficiency class A with reasonable effort, urgently needed investments in their refurbishment are not promoted by the current design of the Taxonomy. Although the refurbishment of buildings in classes G and F to a sustainable level of B or C would have an enormous climate protection effect, it would be contrary to the strategy of investors who strive for energy efficiency class A to leverage this effect.

However, renovations of such buildings up to efficiency class A are technically difficult to achieve or would often even be more expensive than a new building. In such cases, it is therefore more logical to demolish the building and replace it with a Taxonomy-compliant new building. However, this does not correspond to the EPBD-approach, because it leads to avoidable CO₂ emissions and additional consumption of raw materials. In this respect, the Taxonomy represents a regulatory disincentive that should absolutely be avoided.

Solution: Addition of a Dynamic Component to the Taxonomy Regulation

To ensure that the Taxonomy supports the channelling of investment capital into buildings in the lowest energy efficiency classes, it would be an appropriate way forward to add a dynamic component to the Taxonomy Regulation that rewards particularly large climate protection effects achieved during a refurbishment.

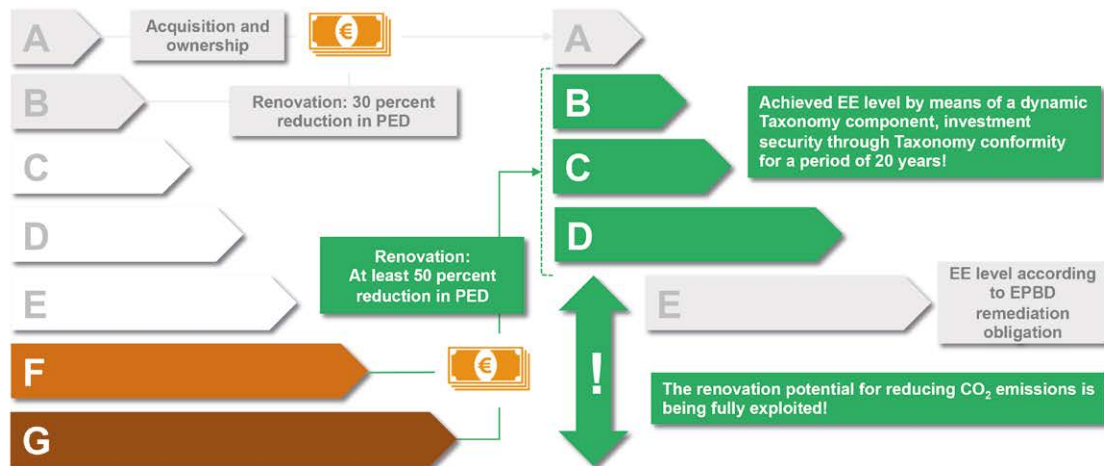
C. Approach of a Dynamic Taxonomy Component

Petition

In order to succeed in channelling private investment capital specifically into the core refurbishment of buildings in energy efficiency classes G and F, ZIA proposes: Properties with a primary energy demand reduced by at least 50 percent within five years will also be classified, for a period of 20 years, as Taxonomy-compliant in terms of achieving the sustainability goal of climate protection.

Introduction of a Dynamic Taxonomy Component

2024



With the introduction of a dynamic Taxonomy-component, comprehensive energy refurbishment activity for properties in lower energy efficiency classes is stimulated by appropriate investment protection in support of the new EPBD requirements. The image above is based on the breakdown of energy efficiency classes in Germany.

Proposed Amendment

Therefore, we propose the following amendment to the European Commission Delegated Regulation (EU) 2021/2139 of 4 June 2021 supplementing Regulation (EU) 2020/852 of the European Parliament and of the Council:

7.7. Acquisition and ownership of buildings

Technical screening criteria

Substantial contribution to climate change mitigation

1. **(a)** For buildings built before 31 December 2020, the building has at least an Energy Performance Certificate (EPC) class A. As an alternative, the building is within the top 15% of the national or regional building stock expressed as operational Primary Energy Demand (PED) and demonstrated by adequate evidence, which at least compares the performance of the relevant asset to the performance of the national or regional stock built before 31 December 2020 and at least distinguishes between residential and non-residential buildings.

1. **(b) Buildings for which primary energy demand in operation has been reduced by at least 50% over a period of 5 years. To prove this, a building energy demand certificate must be submitted before and after the measure. For a building identified in this way, a significant contribution to the sustainability goal of climate protection for the economic activity of acquisition and ownership of buildings is deemed to have been made over 20 years from the reduction of at least 50% of the primary energy demand, but not beyond the year 2050.**

D. Explanation

A refurbishment of existing buildings that are particularly inefficient in terms of energy, far beyond the minimum required by law, up to efficiency class D, C or B, makes a considerably greater contribution to climate protection and sustainability than the energy improvement of a property that is relatively efficient in terms of energy anyway, so that it achieves efficiency class A. Since the latter activity leads to the property of efficiency class A being recognised as Taxonomy-compliant, it is consistent to create a complementary option for the **economic activity acquisition of and ownership of buildings** with regard to their significant contribution to climate protection for those measures also that result in a significant reduction of the primary energy demand and through which the highest possible refurbishment potential is exploited. A 50 percent reduction in primary energy demand by far exceeds the minimum requirements for refurbishment prescribed by the EPBD, and it produces almost twice the positive climate effect of a renovation measure that is already recognised as Taxonomy-compliant with a 30 percent reduction in primary energy demand.

The proposed addition to the Taxonomy creates investment security for real estate investors over a sensible amortisation period, which makes it possible to upgrade one's own existing properties in the worst energy efficiency classes and then keep them in the portfolio without burdening the own "green portfolio".

From a practical point of view, renovations that lead to a 50 percent reduction in primary energy demand are considered to be technically feasible. This target is far more ambitious than the statutory minimum requirement it thus takes into account the guiding principle of the taxonomy to define the highest ambition target based on science.

Extension of the Taxonomy to include the Idea of Transformation and Transition

In the Taxonomy, which so far only provides incentives for investments in the "best of the best" properties, the proposed extension introduces a new element by which the transformation of the building sector and thus the transition towards climate neutrality is specifically stimulated. This is urgently needed against the background of the tight time frame within which the European climate targets are to be achieved.

The proposal can be implemented in the short term and does not require several years of preparatory discussions in working groups, as can be expected in connection with the upcoming traffic light Taxonomy for defining differentiated transition activities.

Classification under the Economic Activity Acquisition and Ownership of Buildings

Even if a renovation measure to reduce the primary energy demand by 50 percent would technically fall under the economic activity **7.2. Renovation of existing buildings**, it should be seen as a component of the economic activity **7.7. Acquisition and ownership of buildings**: Only a classification under 7.7. reflects the economic reality according to which institutional investors manage their portfolios. On the other hand, the costs for the described refurbishments are so high that they are equivalent to a full-fledged building investment in terms of the required capital volume. Accordingly, these refurbishment investments should be classified and — if the specified goals are achieved — lead to the definition of the entire property as Taxonomy-compliant.

Necessary Time to Amortise the Renovation Investments

For the newly to be introduced option to be used in practice and the considerable investment sums required, investors must be guaranteed a payback of these investments. This should be guaranteed over a secure period of time without the fully refurbished property being prematurely deemed no longer Taxonomy-compliant due to a further tightening of regulation.

In this respect, a grandfathering period of 20 years would be appropriate. This period is a timeframe within which the necessary investments for refurbishment can be amortised. After the expiry of this grandfathering period, the building is reassigned to the system of energy efficiency classes and the resulting classification in the Taxonomy according to its building energy performance certificate.

Exclusion of Abuse

The temporal applicability of grandfathering should be limited to 2050. This addresses concerns that the proposed regulation could be exploited to implement refurbishments in line with the present proposal shortly before 2050 to achieve grand-fathering beyond this date. At the same time, it incentivises early investments in the immediate future so that the full grandfathering of 20 years can be exploited.

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The German Property Federation (ZIA) is the umbrella organisation of the German real estate industry. Through its members, including 33 associations, it speaks for around 37,000 companies in the industry along the entire value chain. ZIA gives the real estate industry in all its diversity a comprehensive and uniform representation of interests that corresponds to its importance for the national economy. As an association of companies and associations, it gives the entire real estate industry a voice at national and European level — and in the Federation of German Industries (BDI). The president of the association is Iris Schöberl.

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