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#2 *MARCH 2023*

EUROPEAN M&A MAGAZINE
CREATED BY

Fusions & Acquisitions
La première revue des rapprochements d'entreprises

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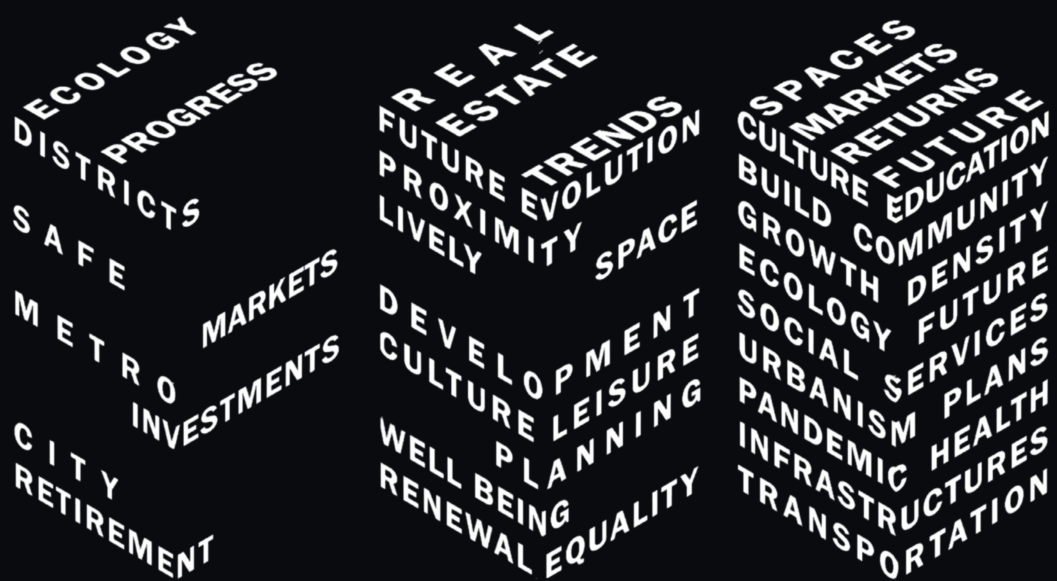

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REAL ESTATE INVESTMENTS 2023 : THE MAIN TRENDS

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MARCH 2023 #2
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PRINTED BY
DUPLICAPRINT
15 RUE DU PETIT SAINT-DIÉ
88100 SAINT-DIÉ-DES-VOSGES
FRANCE

PUBLISHED: 14 MARCH 2023
PRICE: FREE

EDITORIAL

Real estate investment in 2023 and beyond

by Marina Guérassimova & Stefan Schneider

What was the impact of Covid and the war in Ukraine on the real estate sector and its main trends ?

This special issue allowed us to ask this question to some of the "key players". Although different in terms of origins, objectives and investment strategies, all these players agree on a number of points.

"The entire real estate industry has started to move ahead and is now fully integrating ESG issues into its behaviours," says Hadrien Karabachian, Transaction Manager, Real Estate, at BlackRock Alternatives.

Whether you are convinced or not, ESG has become the key word for any real estate deal. The reason is simple. Everybody is concerned: driven by good sense or ... by the new legislation. Let us not forget that the ESG is composed of three letters. The 'E' is often highlighted, given the climate emergency, but the 'S' and 'G' are no less important. Inclusion, equity and diversity are the keywords of tomorrow.

Regarding the mega-trends, they have not really changed despite the challenging environment. "Demographic developments have not changed direction, with an ageing population (especially in Europe), new family units developing (single-parent or blended families, etc.), as well as the phenomena of urbanisation (as large urban areas continue to attract the bulk of economic activities), of digitalisation (as we live in a society that aspires to minimise space-time barriers) and, last but not least, decarbonisation," says Amal del Monaco, CEO Asset Management & Development at Patrizia.

Many of these mega-trends are also, "part of ESG approaches, which have become indispensable in recent years. We are therefore constantly adjusting the way our asset portfolios are assembled to take this into account," continues Jean-Maxime Jouis, CEO of BNP Paribas REIM France.

Without really changing the trends, Covid has hovever changed the situation, particularly for the office segment. "After Covid, there was a lot of thinking around work environments. We realized that offices were not only a place of production but also, and above all, a place for social interactions," reminds Omar Fjer, Managing Director at Ardian. The real estate players are currently facing many challenges. There are numerous tracks to explore to rethink the real estate sector.

One thing is sure: offices remain one of the leading asset classes in Europe in a wait-and-see market. "We expect logistics assets to drive the market actively, as the value correction in this sector has been the most abrupt and severe ," says Hadrien Karabachian. Last but not least: the challenge of the energy transition for which "private investors will have their role to play".

That being said, investors attitude remains cautious because the main European markets - France and Germany included - have not yet "corrected" their prices.

This special issue was edited with the assistance of Alexandre Bal, ESCP Business School Alumni

MAIN TRENDS IN REAL ESTATE M&A IN EUROPE

by Sabine Reimann, Rechtsanwältin, Partner, Hogan Lovells Int. LLP

Hogan Lovells

Increase in interest rates, increase in constructions costs, energy crisis, Ukrainian war as well as sustainability – these are the themes which are talked about a lot in the real estate branch European wide. The following article examines the theme of ESG not only from the perspective of the property, but also from the perspective of the companies that are confronted with the theme of ESG as users, managers or owners of real estate. This is because ESG in the real estate industry does not only concern the question of sustainability of the property itself, but also many companies of the branch in corporate governance.

1. AREAS OF VALIDITY

In the meantime, many companies take into account the principles of Regulation (EU) 2020/852 (Taxonomy Regulation), Regulation (EU) 2019/852 (Sustainable Finance Disclosure Regulation) and the Delegated Regulation regarding the climate targets climate protection and adaption to the climate change (Delegated Regulation (EU) 2021/2139) as well as the corresponding directives in their investment decisions and corporate governance. For many, it is difficult to assess the area of scope and application as well as the extent of the obligations.

The Taxonomy Regulation and the SFDR as cornerstones of ESG regulation apply to financial market participants such as banks, insurance companies, funds and financial advisors as well as publicly effective/"large" companies and enterprises, which can be both participants in the real estate sector and users of real estate.

Since 1 January 2023, the Supply Chain Sourcing Obligations Act (LieferkettenorgfaltspflichtenG), which follows from the EU Corporate Sustainability Due Diligence Directive 2022/0051 and applies to companies with more than 3,000 employees and, from 2024, to companies with more than 1,000 employees in Germany (this is, after all, around 3,100[1] companies throughout Germany), must also be observed. This already shows how many companies - regardless of sector and focus of activity - have to observe ESG criteria.

In addition to the directly applicable EU regulations, there are a large number of directives that deal with themes of sustainability in the field of ecology as well as in the areas social and government. Many of these have already been transposed into applicable law in Germany. MIFID II (Directive 2014/65/EU (recast of the Financial Markets Direc-

[1] Quelle: https://de.statista.com/statistik/daten/studie/1929/umfrage/unternehmen-nach-beschaeftigtengroessenklassen/

tive)), for example, led to a large number of company-related changes. Many of these have already been implemented as applicable law in Germany. Even though the implementation of this directive was mainly reflected in a tightening of the reporting obligations of financial market participants and companies in their financial market reports and balance sheets, such as the regulations on management and sustainability reports in §§ 289b-e, 315b-d of the German Commercial Code (HGB), there were also effects in the regulations of the General Equal Treatment Act (AGG), the Remuneration Transparency Act (Entgelttransparenzgesetz) and in the regulations on the minimum participation of women in the executive board (§ 76 para. 3a AktG), supervisory board and other regulations. The same applies at the real estate level - the Energy Performance of Buildings Directive 2010/31/EU and its revision in Directive 2018/844 and the Energy Efficiency Directive 2012/27/EU for the overall efficiency of buildings were implemented in the Building Energy Act (GEG) and replaced the Energy Conservation Act, the Energy Conservation Ordinance and the Renewable Energies Heat Act.

2. WHAT DOES THAT MEAN IN DETAIL FOR THE COMPANIES IN THE REAL ESTATE SECTOR?

2.1 Duties to report as financial market participant

Financial market participants are the main target group of the ESG regulations. Anyone who is a financial market participant within the meaning of Art. 2 No. 1 SFDR or who distributes financial products within the meaning of Art. 2 No. 12 of the SFDR is obliged to disclose which strategies for incorporating sustainability risks are taken into account in investment decisions (Art. 3 SFDR). It should be noted that the company does not report on itself, but on the investment product "real estate" and its investment strategy.

As of January 2023, every financial product must be declared in a so-called PAI statement (principal adverse impact), which - here related to the investment product "real estate" - are the most important negative impacts on sustainability criteria and how these were taken into account in the investment decision. This also applies if the investment product is not a so-called "green" investment product (i.e. not a real estate fund in the sense of Art. 8 or Art. 9 of the Taxonomy Regulation). Therefore, for each investment decision in a (real estate) product, statements must be made on what adverse effects this investment decision has on the sustainability factors. In the case of investments advertised as "green", it must also be disclosed which climate goal is primarily being pursued and what effects this decision has on the other climate goals (not significantly damaging). There is a disclosure obligation on the financial product's own website.

2.2 Reporting obligations for the company itself

But the company itself can also be subject to reporting obligations, namely from the various laws implementing the Corporate Sustainability Reporting Directive (CSRD). "Corporate Social Responsibility" (CSR) is defined as the social responsibility of companies in terms of sustainable economic activity. From 2024, the CSRD obliges all companies with 250 or more employees and a balance sheet total of more than 20 million euros and a turnover of more than 40 million euros to publish sustainability reports. From 2026, this also applies to all capital market-oriented small and medium-sized companies if they have an annual average of more than 10 employees, a balance sheet total of more than 350,000 euros and net sales of more than 700,000 euros. Since only two of these three size criteria need to be exceeded in each case, a large proportion of companies operating in the real estate sector will be affected.

The exact content of the corporate sustainability report is still rather vague. It is to report on all circumstances that are material either for reasons of business success or from ecological or social point of view. Sector-specific standards are to be prepared in packages over the next three years, for the first time in 2023. In any case, however, information on the environmental objectives of the Taxonomy Regulation, information on social aspects (such as equal opportunities, working conditions and respect for human rights) as well as information on governance aspects (such as business ethics, anti-corruption and risk management systems, etc.) will have to be included.

The consequence of this is that, when renting, companies subject to CSR reporting requirements in particular attach great importance to ecological building standards, but also to ecological management. These obligations are usually laid down in green leases and must be substantiated by corresponding building certifications on the part of the lessor. In order to enforce ecological management of the property, corresponding specifications in property and asset management contracts are indispensable.

2.3 Reporting obligations as service provider

Real estate service providers are the backbone of the industry, whether in direct advisory and management or indirectly in valuation, financing, etc. These companies can be reportable for themselves as a company as well as for the investment product real estate or be part of the supply chain. But even if a service company is not "large" in the sense of the Disclosure Regulation, hardly any financial market participant that launches a sustainability fund or a portfolio holder that wants to manage its real estate portfolio in an ecologically sustainable way and thus also be interesting for companies subject to disclosure requirements as landlords will employ a service provider that is not committed to sustainability. As a rule, companies managing real estate investment products, banks and listed companies will no longer award contracts if the contractor does not submit to the specified compliance standards.

In order to fulfil their reporting obligations, the reportable companies are dependent on the corresponding data being collected in accordance with the rules, i.e. in particular taking into account the GDPR. But also as part of the supply chain, the service provider must meet these requirements and present itself and its services in such a way that the client can prove compliance with the protected legal position within the meaning of Section 2 LkSG as part of the risk management incumbent upon it.

3. SUBSTANTIVE DUTIES

3.1 *Property as financial product*

After many initial uncertainties, the Delegated Regulation 2021/2139 on Climate protection and the adaptation to the climate change now provides hints and specifications on which technical requirements buildings must fulfil in order to be sustainable in the sense of sustainability reporting for financial products according to Art. 2 No. 17 SFDR. If the property is judged as a financial product, the focus should - unlike for companies - be 70-85% on E, the environmental sustainability of the property, and only 15-30% on the criteria S and G. For the other four environmental objectives, corresponding Delegated Regulations are to come into force in the year of 2023. The financial sector is now well positioned and via various certificates and scorings has developed regulations to assess real estate on sustainability. These should be critically revised in the course of the further Delegated Regulations on the other four climate targets expected in 2023. For the certificates the quality and competence of the exhibitors is also very important.

3.2 *Real Estate in general*

But even if the specific property is not owned by a fund etc., i.e. it is not a financial product in the sense of the SFDR, it is advisable to pay attention to environmental goals at the property level in the future and to develop strategies to save CO^2. Various directives defining the ecological standards of buildings have already been adopted (e.g. the Directive on the Energy Performance of Buildings, which was transposed into national, German law by the Building Energy Act (GEG)). The Energy Performance of Buildings Directive is currently being revised to make buildings in the EU more energy efficient by 2030 and beyond. The main aim of the new regulations is to achieve,

- That all new buildings will be zero-emission buildings by 2030
- All existing buildings will be changed into zero-emission buildings by 2050

This project is communicated as "Fit for 55". "Fit for 55" refers to the EU's target to reduce net greenhouse gas emissions by at least 55% by 2030. The consensus is that from 2028 new buildings owned by public institutions should be zero-emission buildings and from 2030 all new buildings should be zero-emission buildings. Only historic buildings, churches and buildings for defence purposes are exempt.

For existing buildings, EU-Member States have agreed to introduce minimum energy performance targets corresponding to the maximum amount of primary energy that buildings can consume per square metre per year. For existing non-residential buildings, this means that maximum energy performance thresholds will be set based on primary energy consumption. The first threshold would draw a line below the primary energy consumption of 15 % of the non-residential buildings with the worst energy performance in the EU-Member State concerned. The second threshold would be below 25 %. The aim is to bring all non-residential buildings below the 15 % threshold by 2030 and below the 25 % threshold by 2034. This also means the introduction of new energy performance certificates with the classifications A+, A0 - G. As these are threshold values at EU Member State level, the absolute values of primary energy consumption for the individual classifications may differ in the EU Member States.

For existing residential buildings, each EU-Member State is to set minimum energy performance targets that, with step by step renovation, should lead to a zero-emissions building stock by 2050. The aim is to make the achievement of the EU's climate target of reducing emissions in the EU by at least 55% by 2030 a legal obligation and to raise all buildings to at least a D level. All EU countries are working on correspondend new legislation. In some neighbouring countries - e.g. the Netherlands and the UK - parts of it have already been implemented and also lead to bans on use if the standards are not met. The EU plans to provide funding for these upcoming building renovations.

4. RESULT

There are a lot of rules and regulations to follow. At both the real estate and the corporate level, concrete goals for sustainability management are essential. In any case, honest communication and engagement with the ESG goals are mandatory.