

# Sustainable Investment Principles

- > SFDR's ambiguous criteria for classifying real estate as 'sustainable investments' have led to confusion. Market-driven strategies can support real estate investment managers in assessing sustainable investments, including environmental and/or social contributions, DNSH thresholds and clarifying good governance principles.
- > Additionally, a checklist for disclosing under SFDR Article 9(3) assists real estate transition funds with carbon reduction strategies by covering key aspects such as selecting a relevant science-based standard, defining a clear methodology, and effectively communicating these to investors.

## Introduction

The outcomes of the [2023 INREV Sustainable Investments survey](#) showed that there is considerable confusion about the definition of a 'sustainable investment'. Existing regulations focusing on sustainable investments, such as Sustainable Finance Disclosure Regulation (SFDR) and EU Taxonomy, leave room for interpretation.<sup>1</sup> SFDR, specifically allows for custom thresholds. This can lead to market variations and increased complexity. Despite regulatory guidance<sup>2</sup> and proposed changes,<sup>3</sup> uncertainties about how to comply with these regulatory requirements persist.

Investment managers seek clear and consistent guidance to apply regulatory definitions of sustainable investments across different real estate investment managers. A widely accepted understanding of sustainable investments is therefore key for effective communication with stakeholders such as investors, tenants, and asset managers.



This paper provides a set of guiding principles for sustainable real estate investments, based on the sustainable investment framework under SFDR. It considers evolving market

expectations and incorporates insights from various experts, the INREV ESG committee and specialist groups within the real estate industry.

<sup>1</sup> More in [INREV's publication 'Falling through the cracks: SFDR's impact on real estate investment'](#).

<sup>2</sup> See [Consolidated Q&A on the SFDR and the SFDR Delegated Regulation](#).

<sup>3</sup> See [Final Report on draft Regulatory Technical Standards \(RTS\)](#), INREV's recent response to Commission consultation on SFDR, and ESMA works on [Guidelines on funds' names](#).

The focus is on real estate assets, aiming to clarify the application of sustainable investment principles at the asset level, regardless of the legal investment structure or asset location. Specifically, the objectives of this paper are as follows:

- Providing clarity on the key elements and the various choices and alternatives for regulatory reporting under SFDR, so the regulation can be appropriately applied to real estate.
- Suggesting additional indicators to define sustainable investments in real estate, aligning with current market ambitions.

**DISCLAIMER:**  
Adherence to these guiding principles is not mandatory for regulatory compliance.

## Assessing sustainable investments

This paper provides pathways to help market participants evaluate if an investment qualifies as 'sustainable'. The approach is based on the definition of sustainable investment in Article 2(17) of the SFDR, which is as follows:

Following this definition, the assessment of sustainable investments can be broken down into three steps:

1. **Contribution to an environmental and/ or social objective;**
2. **Do no significant harm (DNSH);**
3. **Good governance practices.**

In the subsequent sections, we detail the regulatory requirements, outline market expectations, and provide examples for these steps. This framework is designed to guide real estate investment managers in formulating their own definition of sustainable investments.

“sustainable investment’ means an investment in an economic activity that **contributes to an environmental objective**, as measured, for example, by key resource efficiency indicators on the use of energy, renewable energy, raw materials, water and land, on the production of waste, and greenhouse gas emissions, or on its impact on biodiversity and the circular economy, or an investment in an economic activity that **contributes to a social objective**, in particular an investment that contributes to tackling inequality or that fosters social cohesion, social integration and labour relations, or an investment in human capital or economically or socially disadvantaged communities, provided that such investments **do not significantly harm** any of those objectives and that **the investee companies follow good governance practices**, in particular with respect to sound management structures, employee relations, remuneration of staff and tax compliance.” (source: [SFDR regulatory text](#))

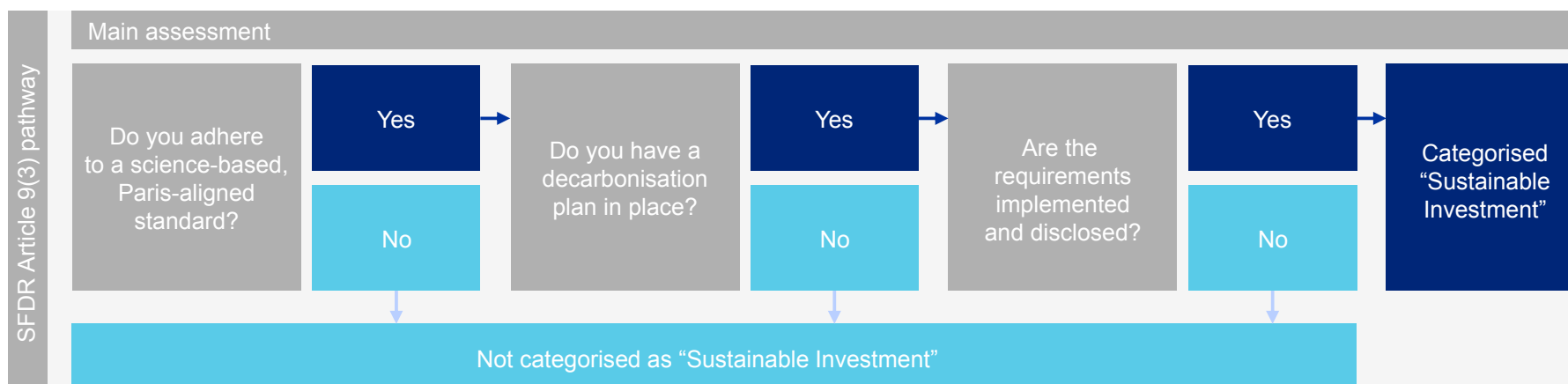
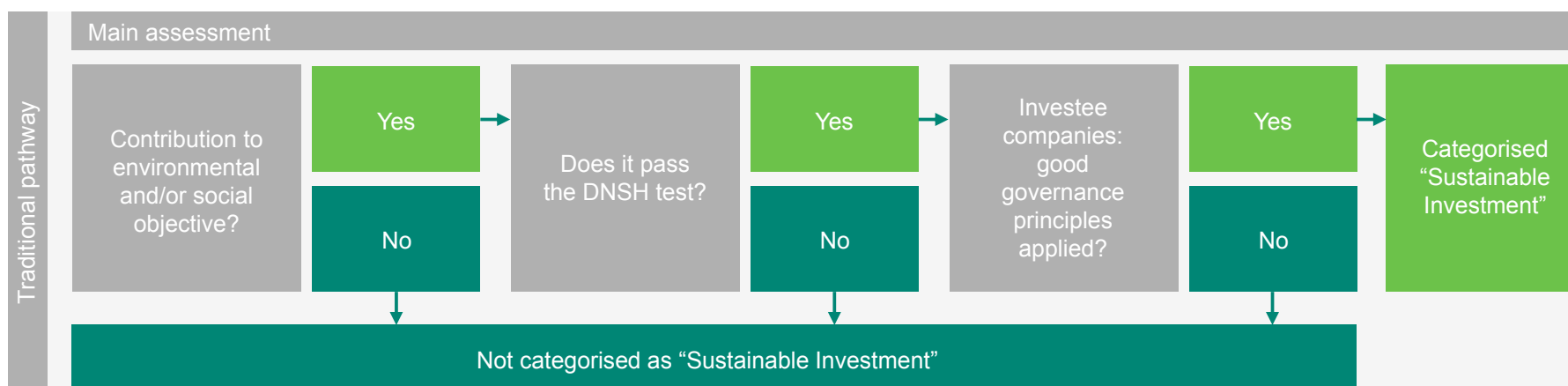


## Contribution to environmental and/or social objectives

### Regulatory requirements

The first step in evaluating sustainable investments involves determining the asset's contribution to an environmental and/or social

objective. SFDR currently does not provide a specific list of contribution areas or methods, so investment managers have to set their own goals and thresholds. When doing so, investor expectations in the market should be considered.



### Market expectations

The following table illustrates several potential environmental and social contribution areas. These should be aligned with both the strategic goals of the manager and the expectations of investors. When establishing goals and thresholds, a number of key elements should be considered:

- **Contribution themes:** broad areas where investments can make a significant impact.
- **Objectives:** the specific goals associated with each theme, outlining the intended positive change.
- **Asset level metrics:** examples of measurable indicators that can demonstrate the achievement of these positive outcomes.

	Contribution theme	Objective	Asset level metric
EU Taxonomy	EU Taxonomy alignment	Make targeted investments in sustainable assets.	The asset should meet the “substantial contribution” for at least one of the six environmental objectives of the EU Taxonomy (climate change mitigation, climate change adaptation, sustainable use and protection of water and marine resources, transition to a circular economy, pollution prevention and control, protection and restoration of biodiversity and ecosystems) - and meet the requirements of do not significant harm on the rest.
Other environmental	Net zero carbon (NZC)	Decarbonisation of the built environment by alignment with the Paris Agreement. Achieved by implementation of a NZC strategy. <sup>4</sup>	The asset should meet a certain Energy Use Intensity (EUI), or Carbon Intensity threshold informed by applying a science-based approach by using, for example, the Carbon Risk Real Estate Monitor (CRREM) 1.5° pathway, or other industry benchmarks. Based on the investment strategy, thresholds should be informed by the current year pathway or by a pathway towards a set target year and consumption. Guiding principles
	Valid green building certifications <sup>5</sup>	Measure the building’s environmental and/or social sustainability performance within an acknowledged framework.	Investment managers should select a credible certification and target level based on current market expectations. They should consider renewal requirements for in-use certifications. A reasonable timeframe should be applied for new-built certifications.
	Climate adaptation	Contribution to resilient built environment.	The asset meets EU Taxonomy requirements for significant contribution. <sup>6</sup>
Social	Affordable housing	Addition of housing units that are affordable to buy or rent by the low-income section of a society. <sup>7</sup>	Proportion of annual rent income and/or of value from affordable units within investment.
	Social impact	Increase of healthcare or education facilities.	The asset meets an identified social need, based on a credible social impact assessment (referencing an external standard, such as the OECD wellbeing indicators or the SDG indicators).

Note: This list is not exhaustive, and additional positive contributions may be considered.

<sup>4</sup> Managers to choose most suitable NZC definition, and follow [INREV guidance on NZC strategies](#).  
<sup>5</sup> For an extensive list of certifications and their validity evaluation, refer to the [GRESB green building certification form](#).  
<sup>6</sup> See: [Chapter 7.7 of EU Taxonomy Delegated Act](#).  
<sup>7</sup> See: [INREV definition of affordable housing](#).



## Case studies

To help illustrate the three steps for assessing a sustainable investment and their application across different local contexts, two fictional

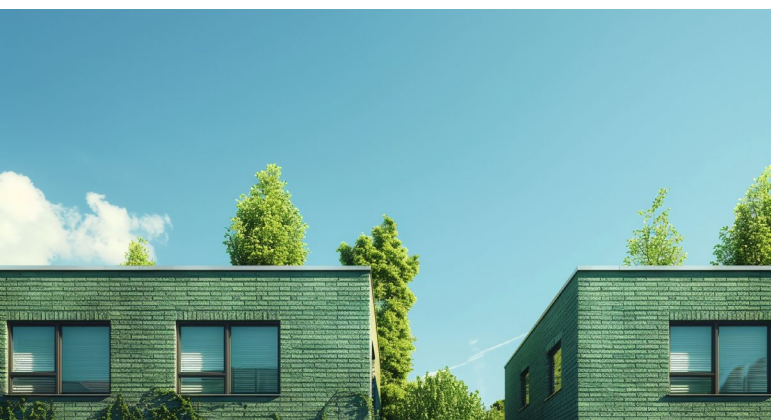
case studies are presented throughout this paper. These examples are for illustrative purposes only, and actual local legislation

and requirements may differ. The figures used in the case studies do not represent the performance of any specific organisation.



### **Situation: London “GreenHub” is a centrally located office building designed with sustainability in mind.**

Contribution to environmental objective: By implementing solar panels and rainwater harvesting systems, the building has achieved a current greenhouse gas (GHG) emission intensity of 20 kgCO<sub>2</sub>e/m<sup>2</sup>/year, positioning it below the current CRREM 1.5° pathway for London, with a current stranding year of 2028. Plans are in place to further reduce GHG emissions to 15 kgCO<sub>2</sub>e/m<sup>2</sup>/year by 2030, by utilising efficient HVAC systems and installing LED lights. The building’s owner commits to annual disclosure of both Energy Use Intensity (EUI) and GHG emission intensity, demonstrating a dedication to transparency and continuous environmental enhancement, thus making a significant contribution to the reduction of greenhouse gases.



### **Situation: “Groenhof Rotterdam” addresses Rotterdam’s affordable housing shortage, prioritising sustainability within its residential offerings.**

Contribution to social objective: Through government incentives and a mixed-income model, Groenhof has increased its affordable housing provision. 65% of the units are affordable, maintaining housing costs below 30% of the current median household income in the Netherlands. The manager has researched local affordability requirements and housing needs, ensuring alignment with the affordable housing objectives of the municipality. Annual reports display the percentage of units meeting Rotterdam’s affordable housing criteria, underscoring the Fund’s dedication to expanding housing access and promoting community inclusivity.

## Do no significant harm (DNSH)

### Regulatory requirements

The DNSH assessment under SFDR is a comprehensive process designed to limit negative impacts and ensure that investments do no significant harm to sustainability factors. Investment managers should identify which areas are relevant to their investments and establish their own criteria within this framework.

Even though investments managers have discretion over this process,<sup>8</sup> there are two mandatory PAI indicators for real estate that have to be included: exposure to inefficient assets, and exposure to fossil fuels.<sup>9</sup> Beyond these mandatory indicators, investment managers should also assess and set thresholds for any additional relevant PAI indicators and DNSH themes.

The following section elaborates on the essential aspects of the mandatory PAI indicators:

### 1. Exposure to inefficient assets

- a. For buildings that were granted building permits before December 31, 2020, inefficient assets are classified using two methods: the Energy Performance Certificate (EPC) rating or the Primary Energy Demand (PED).

According to the final report on the draft Regulatory Technical Standards (RTS),<sup>10</sup> assets are deemed inefficient if they have an EPC rating of D or worse, or a PED that does not rank within the top 30% nationally. This is a proposed change from the previous criteria set by the regulator, which considered an EPC rating of C or below as inefficient.

These latest proposed regulatory changes are anticipated to take effect mid-2025. Until these changes are effective, it is required to have an EPC rating of B or higher for assets to be deemed 'efficient'.

- b. For buildings that were granted their building permits after December 31, 2020, the identification of inefficient assets is determined by having a PED worse than the Net Zero Energy Building (NZEB) threshold for the country where the asset is located.

### 2. Exposure to fossil fuels

Requires an assessment as to whether a given real estate asset is active in the extraction, storage, transport, or manufacture of fossil fuels.

**The DNSH assessment under SFDR is a comprehensive process designed to limit negative impacts and ensure that investments do no significant harm to sustainability factors. Investment managers should identify which areas are relevant to their investments and establish their own criteria within this framework.**

Together with other relevant criteria, these two indicators are integral to conducting a comprehensive DNSH assessment.

### Market expectations

Implementing the mandatory PAIs defined by the regulation can be challenging, as they may not be suitable for all assets — for instance, some regions may lack necessary measures for assessment. Investment managers might explore alternative measures in these instances, as illustrated below.

<sup>8</sup> It is technically possible that a mandatory Principal Adverse Impact (PAI) indicator of SFDR will not affect sustainable investment categorisation from a legal perspective.

<sup>9</sup> SFDR Annex 1 Table 1 Real Estate PAI 17 and 18.

<sup>10</sup> See [Final Report on draft Regulatory Technical Standards \(RTS\)](#).

## 1. Exposure to inefficient assets

If no EPC or PED threshold is available, and the building does not fall under the Energy Performance of Buildings Directive (EPBD), alternative energy performance assessment methods may be used.

- a. Local Taxonomy alignment (eg. ASEAN Taxonomy, emerging local taxonomies).
- b. 'Energy' section of a green building certification scheme, examples include but are not limited to:<sup>11</sup>
  - i. Energy star – minimum of 70;
  - ii. Nabers – minimum of 4 stars;
  - iii. LEED – at least Silver;
  - iv. BREEAM In-Use ENE1 score corresponding with at least Very Good.

Even when an EPC label or PED threshold

is available, investment managers may still choose to use some of these alternative assessment methods, as additional criteria to ensure no significant harm.

## 2. Exposure to fossil fuels

Assessing exposure to fossil fuels can involve a two-step process. First, investment managers should identify if assets are exposed to fossil fuels, focusing on their primary function, related to extraction, storage, transportation, or manufacturing.

If there is exposure, the next step is to evaluate whether this exposure is material, or significant enough to cause harm. Due to the absence of established regulatory benchmarks for assessing harmful exposure levels for fossil fuels, investment managers may set their own thresholds. This determination requires professional judgement based on collected data or qualitative criteria.<sup>12</sup>

**Due to the absence of established regulatory benchmarks for assessing harmful exposure levels for fossil fuels, investment managers may set their own thresholds.**

Factors such as revenue generated from on-site fossil fuel-related operations, the proportion of floor space dedicated to these activities compared to the total asset area, and the asset's overall environmental impact and sustainability are important in this assessment. For example, if a large part of the revenue comes from fossil fuel-related activities, it would cause significant harm.

In general, investment managers should target a 0% fossil fuel exposure. However, up to 5% revenue from fossil fuel activities is often viewed as acceptable by the market,

<sup>11</sup> Regulatory requirements and certification scheme requirements evolve over time, these examples are intended as suggestions only. Managers should identify their own standards and thresholds based on what is most relevant in their local market.

<sup>12</sup> The ESAs pointed out that a Q&A issued by the European Commission about Taxonomy DNSH criteria for real estate, number 117, stated that application of the DNSH criteria depended on the amount of fossil fuels stored and would not be applied if the real estate was dedicated for something different, eg. residential real estate. When part of income stream, it is problematic.

<sup>13</sup> Alternative approaches may be considered, such as correlating value proportion to revenue proportion, given that PAI reporting mandates value disclosure.

not constituting significant harm, for assets with strong sustainability credentials. If revenue percentage cannot be retrieved, the proportion of the market value of the asset may be used for the assessment.<sup>13</sup>

Additional (PAI) indicators	PAI indicator	Example thresholds
Indicators applicable to investments in real estate assets according to SFDR Annex 1, Table 2 Real Estate PAI, where recognised metrics exist	18. Greenhouse gas (GHG) emissions	GHG intensity below local and asset-specific science-based pathway, by using ESG indices or other tools such as the CRREM curve in the current year, if applicable.
	19. Energy use intensity (EUI)	EUI below local and asset-specific science-based pathway, by using ESG indices or other tools such as the CRREM curve in the current year, if applicable.
Other SFDR and market-based indicators that may be seen as relevant to real estate, where there are no standardised metrics	20. Waste production in operations	No uniform metrics exist to determine thresholds for these indicators, reflecting the real estate market's inherent diversity and complexity. Therefore, these indicators are not commonly used by managers. In green building certification schemes such as BREEAM, LEED, DGNB, although most of these themes are considered, a uniform metric by itself is not widely applied. Dependent on strategy, investment managers may well choose to set thresholds for these indicators, albeit this practice is not widespread.
	21. Raw materials consumption for new construction and major renovations	
	22. Land artificialisation	
	Biodiversity	
	Water	

Note: This list is not exhaustive, and additional indicators and/or criteria may be considered.



## Case studies



### Contribution to environmental objective:

London GreenHub contributes by integrating renewable technologies and committing to transparency through annual emissions disclosures, targeting Paris-proof status by 2040.

### DNSH:

The asset adheres to the DNSH criteria by holding an EPC A+ label, having no exposure to fossil fuels and being below the current year CRREM GHG and EUI pathway for office buildings in London. It is aligned with EU Taxonomy requirements and holds a BREEAM In-Use Excellent certification. Waste generation is minimised and there is an on-site recycling facility.



### Contribution to social objective:

Groenhof Rotterdam enhances affordable housing access and annually discloses the proportion of units meeting local affordability criteria.

### Do no significant harm:

Groenhof Rotterdam holds an EPC label C. This is currently officially deemed “inefficient” by mandatory SFDR PAI 18. This project minimises negative impacts on several fronts: even though label C will likely be deemed ‘efficient’ soon, it reduces greenhouse gas emissions and lowers energy consumption, informed by the local CRREM 1.5° pathway. It is currently just below the CRREM curve for residential assets but has a clear strategy to reach net zero before 2050. No hazardous waste is produced on-site. Efforts are made to decrease raw materials use in maintenance activities.

## Good governance practices

### Regulatory requirements

When assessing the status of sustainable investments, investment managers should undertake a minimum safeguard analysis. For regulated investment vehicles this will generally be covered throughout the value chain of the business.

Under SFDR, the assessment of good governance (eg. to determine if an investment can fit within an Article 8 or 9 strategy) only applies to investee companies.<sup>14</sup>

If a fund is investing directly in real estate assets, there is no requirement under the SFDR to consider good governance.

### Market expectations

Investing in real estate under SFDR does not always require adherence to good governance principles, yet investors expect investment managers to uphold these standards.

[The Governance and Sustainability modules of the INREV Guidelines](#) offer a foundational framework alongside tenant exclusion criteria, environmental management systems for property management activities and human rights policies.



<sup>14</sup> Real estate investments can be made through special purpose vehicles (SPVs), operating companies and investment vehicle structures designed to operate in accordance with applicable regulations, eg. AIFMD.

## Example sustainable investment definitions

### Case studies

In the previous sections of the paper, the steps for assessing sustainable investments were illustrated using fictional case studies. Example definitions of sustainable investments are provided below for the underlying strategies in both case studies.

The manager of London GreenHub has defined sustainable investments as follows:

#### 1. Significant contribution

Net zero carbon - The assets should be under the current CRREM 1.5° curve for the specific area, both for energy intensity and carbon intensity.

#### 2. Do No Significant Harm criteria – based on the SFDR PAI indicators.

- No exposure to energy inefficient assets as defined in this paper.
- Maximum 5% exposure for each asset in portfolio.
- Green building certification: asset rated with BREEAM In-Use Very Good or higher.

#### 3. Good governance – based on SFDR requirements

- I. 100% compliance score for INREV Governance guidelines.
- II. Due diligence process for adverse supply chain impacts carried out. Asset manager has developed sustainability guidelines for the appointment of property managers and contractors for each asset.

The manager of Groenhof Rotterdam has defined sustainable investments as follows:

#### 1. Significant contribution

Affordable housing – asset should contribute to local affordable housing offering, by ensuring at least 60% of units in an asset is deemed affordable following local standards.

#### 2. Do No Significant Harm – based on the SFDR PAI indicators.

- Net zero carbon: Asset should be net zero by 2050, aligned with the local CRREM 1.5° pathway.
- No exposure to energy inefficient assets as defined in this paper.
- Maximum 5% exposure for each asset in portfolio.
- Green building certification: asset rated with BREEAM In-Use Very Good or higher.

#### 3. Good governance – based on SFDR requirements

- I. 100% compliance score for INREV Governance guidelines.
- II. Due diligence process for adverse supply chain impacts carried out. Asset manager has developed sustainability guidelines for the appointment of property managers and contractors for each asset.

## Transition strategies under SFDR Article 9(3)

This section addresses sustainable investments within the framework of SFDR Article 9(3). According to SFDR Article 9(3), “when carbon reduction is an objective, the information to be disclosed has to include the objective of low carbon emission exposure in view of achieving the long-term global warming objectives of the Paris Agreement”.<sup>15</sup> This involves following Paris-Aligned Benchmarks (PAB) or Climate Transition Benchmarks (CTB). However, the lack of formal PABs and CTBs for real estate investments necessitates specific considerations to align with SFDR Article 9(3) and classify them as ‘sustainable’:

1. Do you adhere to science-based standards aligned with the Paris Agreement?
2. Do you have a decarbonisation plan in place, covering the below notes?

To ascertain compliance with SFDR Article 9(3) and to categorise real estate investments as ‘sustainable’, it is important to go through the following checklist.

This process is vital for the information disclosed to investors during the product’s due diligence phase:

1. Select a relevant science-based, Paris-aligned standard, such as CRREM.<sup>16</sup>
2. Clearly define the methodology for benchmark tracking, focusing on:
  - Inclusion of all scopes (1, 2, and 3) of carbon emissions from operational energy use;<sup>17</sup>
  - Selection between location-based and market-based methods for operational carbon emissions calculation;
  - Decision between using a portfolio average or individual building assessments against the benchmark;
  - Approach for integrating newly acquired buildings, detailing the grace period for benchmark compliance, assessment based on data availability, and reasonable timelines for meeting benchmark criteria;

- Initiation of benchmark tracking based on investment period completion or a certain asset under management (AUM) level;
  - Expectation for the portfolio/buildings to meet or exceed the benchmark currently or within a future timeframe (eg. 5, 10 years);
  - Handling of the wind-down period for closed end vehicles;
  - Communication and correction mechanisms for benchmark deviations, including time indication for compliance
3. Ensure that all the above is transparently communicated to investors, and comprehensively documented within fund materials.

<sup>15</sup> In the 4 December 2023 final report, the ESAs noted that the “safe harbour” for taxonomy-aligned investments was clarified by the Commission’s Q&A issued in June 2023 confirming the existence of the “safe harbour” and that financial market participants “can rely on it”. The “safe harbour” will presumably also be extended to funds with a carbon reduction strategy that track EU PABs / CTBs if proposed changes to the SFDR Delegated Regulation related to them are adopted soon as expected.

<sup>16</sup> EUI tracking and reduction as part of the broader real estate transition strategy is also recommended.

<sup>17</sup> Consideration of embodied carbon is recommended.



## Conclusion

The ESG regulatory environment is constantly changing, requiring investment managers to develop actionable strategies for navigating the complexities of assessing and reporting on the proportion of sustainable investments in their portfolios.

This paper addresses the ambiguity in current regulations and outlines guiding principles for sustainable investments within the real estate industry. It serves as a practical guide, offering pathways for assessing sustainable investments and facilitating compliance with SFDR.

By identifying areas where investment managers can make environmental or social contributions, offering alternative measures

where PAI indicators may not be applicable, and explaining good governance principles, the paper presents a consistent approach to assessing sustainable investments. This goes beyond legal requirements, proposing a market-based approach aligned with current industry ambitions.

There is a pressing need to transition towards more sustainable real estate practices, aligning investment strategies with environmental and social goals. Future INREV publications will introduce an interactive sustainable investment assessment tool and aim to offer further clarification on the EU Taxonomy.





## Appendix A - Considerations on product level

In the below table, the requirements for disclosure under SFDR Article 8, 9 and 9(3) are mapped to underlying guiding principles.

Article 6 funds do not have a focus on sustainability and are therefore not considered in this exercise.

Funds disclosing under SFDR Article 8, should promote environmental or social

characteristics alongside financial objectives. The information to be disclosed under SFDR must include information on how those characteristics are met. Funds disclosing under SFDR Article 9, have sustainable investment as their objective.

Base indicators	SFDR Art 9	SFDR Art 9(3)	SFDR Art 8
<b>Sustainable investments at asset level, by AUM<sup>18</sup></b>	Given that this is at asset level, this still allows for investment managers to hold liquidity instruments and hedging, which do not need to meet the SI requirements.	If a product is tracking a Paris-aligned decarbonisation benchmark, all investments are deemed sustainable investments.	0%: No regulatory requirement for any proportion of SI's under Article 8 1-99%: Investment managers may choose to differentiate by committing to a certain proportion of sustainable investments
<b>Contribution to social or environmental objective, by AUM</b>	N/A	N/A	>50%: considered market standard. >80%: if sustainability-related terms are used in fund name. <sup>19</sup>
<b>Good governance</b>	●	●	●
<b>DNSH PAI reporting: exposure to inefficient assets (SFDR Annex 1 Table 1 Real Estate PAI 18)</b>	Given the 100% of investments in Art 9 strategy are required to be sustainable, it is assumed that there will be 0% exposure to inefficient assets, as this is a critical component of the SI definition.	A fund following a transition pathway may have inefficient assets, however, following the 9(3) pathway will eventually lead to sustainable investments according to the Article 9 definition.	0-100%

<sup>18</sup> AUM refers to market value of asset as at reporting date.

<sup>19</sup> ESMA Public Statement "[Update on the guidelines of funds' names using ESG or sustainability-related terms](#)".

Base indicators	SFDR Art 9	SFDR Art 9(3)	SFDR Art 8
DNSH PAI reporting: exposure to fossil fuels (SFDR Annex 1 Table 1 Real Estate PAI – 17)	Given the 100% of investments in Art 9 strategy are required to be sustainable, it is assumed that there will be 0% exposure to assets that meet the materiality threshold for fossil fuel exposure, as this is a critical component of the SI definition.	A fund following a transition pathway may have assets exposed to fossil fuels.	0-100%
EU Taxonomy Alignment	0-100%	0-100%	0-100%
Additional indicators that may be used			
Climate adaptation strategy	●	●	●
Valid green building certifications	●	●	●
Mitigation strategy (eg. track EUI and/ or Carbon climate benchmark)	0-100%	0-100%	0-100%