

# INVESTMENT FOR SUSTAINABLE REAL ESTATE IN SOUTH EASTERN EUROPE

By Anjelika Klamp

**EU and EBRD funding and initiatives have contributed to reducing external energy dependency in South Eastern Europe. Private funding is now needed to improve the energy efficiency of building stock.**

The UN's Sustainable Development Goals establish a vision ensuring a more sustainable human activity footprint, with goals for 'Affordable and Clean Energy' and 'Sustainable Cities and Communities'.

Alongside this, more pressing concerns centre around global energy security. The European Commission's 2014 Stress Tests identify Central and South Eastern Europe as at risk of supply disruptions due to geopolitical uncertainties.

To address these dual considerations, the European Commission put in place a framework of initiatives, such as the establishment of Central and South-Eastern European Energy Connectivity (CESEC) in 2015 and the CESEC 2.0 in 2017, as well as various funding streams with the Cohesion Policy Funds (CPFs) and the European Fund

for Strategic Investment (EFSI). While significant progress has been made since in implementing supply-side measures by improving regional market integration and strategic energy infrastructure (the latter also partly achieved through EBRD<sup>1</sup> funding), demand-side measures have lagged.

According to the 2017 report by Building Performance Institute<sup>2</sup> (BPIE), regional building stock still on average consumes 38% of its gas imports, while the European Commission's 2018 report<sup>3</sup> shows that in Romania, in 2015, residential alone represented a 33.7% share of final energy consumption, which is well above the EU average of 25.4%. BPIE estimates that a dedicated renovation programme targeting gas-consuming buildings could reduce the current building stock's gas consumption by 70% within 20 years.

The potential savings from increased energy efficiency of the building stock in the region are obvious. So why have we not seen a greater number of demand-side energy efficiency projects? A closer examination of the amount and types of EU funding available for such projects in the CESEC region provides some answers.

EU funding pools such as the EFSI, designed to leverage private capital, only allocate 1.25% of their committed capital to projects in CESEC. With the EFSI funds mostly targeted to supply-side initiatives in

more mature European markets, the other reliable source of capital for CESEC-focused energy efficiency projects comes from CPFs, currently offering a total funding of €3.96bn to the region. Although in absolute terms a large number, this amount is to be spread over seven years across seven countries and translates into a per square meter investment rate of only € 3 in Romania, as an example. This compares rather unfavourably with Poland, alone scheduled to receive as much as € 3bn over the same seven-year period.

The types of funding most popular for energy efficiency projects are also suboptimal, with non-repayable grants crowding out more efficient types of funding, that could have the potential to unlock larger pools of private financing. Despite the record low interest rates of the past decade, non-repayable grants remain the preferred form of financing, partly due to concerns of breaching EU debt and deficit thresholds.

On the positive side, the EU continues to fund training initiatives on the ground, to improve the energy efficiency competence of the local building trade workforce. These initiatives include Building Knowledge Hubs which disseminate techniques in nearly Zero-Energy Building (nZEB) and deep energy renovations.

Critically though, energy efficiency is just one side of the coin of building sustainability in South Eastern Europe. The



Anjelika Klamp

other side is the resilience of buildings in a region that is periodically affected by earthquakes of varying magnitude. According to a 2016 report by World Bank Group/GFDRR<sup>4</sup>, capital loss from a severe earthquake in Romania and Bulgaria is estimated as high as 11% and 8% of the countries' GDPs respectively, with the annual average affected GDP standing at \$ 20bn across the SEE collectively.

An academic paper by Georgescu et al<sup>5</sup> states that 69% of buildings in existence in Romania in 2011 were constructed prior to the 1977 earthquake. Post 1977, repairs carried out on surviving buildings were limited to the bare minimum, resulting in increased risk of significant damage from future seismic events.

Construction practices have since evolved in the region generally, and in Romania specifically, gradually moving away from the old cast-in-place RC shear wall structures to increasingly using RC framed structures with regular column patterns, more resilient in case of seismic events.

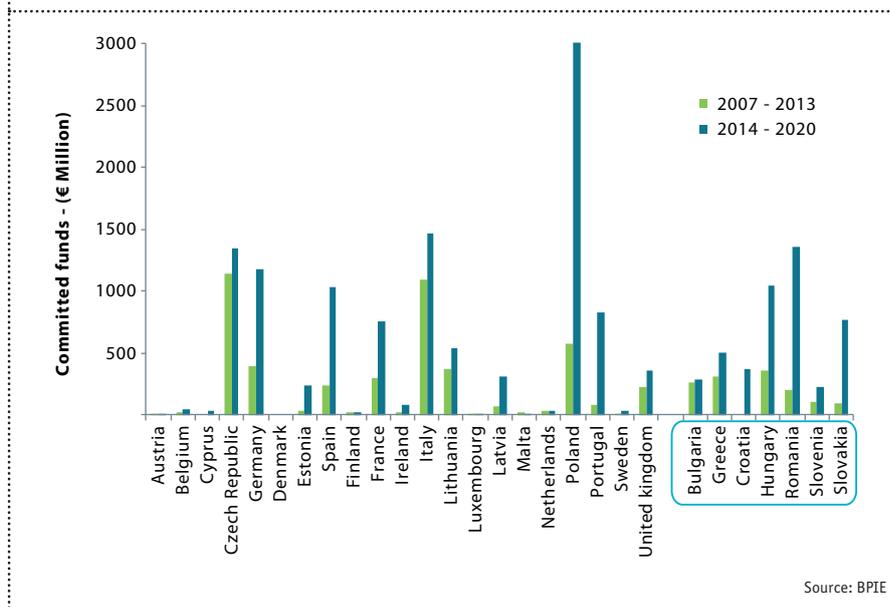
Successive iterations of the Romanian seismic design code, with the last version dating from 2012, have reinforced the requirement to evaluate building risk, and finance remedial works in certain cases. Strengthening techniques prescribed include jacketing of frames or frame bracing, where necessary.

Other changes that improve sustainability of buildings in Romania include the 2007 requirement for developers to supply an energy performance certificate on all new and refurbished structures.

Demand-side factors have had a strong pull effect that has encouraged these changes. An increasing number of stakeholders require a higher standard of sustainability for new buildings in the region, according to David Allen of Chayton Capital, a London-based real estate investment manager and winner of multiple sustainability awards for its SWAN office park in Bucharest.

'Lenders are interested in financing assets

Figure 1: Allocation of CPFs for energy efficiency



Source: BPIE

with healthy D&A characteristics; tenants, whether for office or residential assets, want to minimize their service charge', says David, 'while institutional investors have an increased ESG awareness and push their development and architect teams to prioritise sustainability. Sustainably constructed properties are easier to market, and nowadays local developers increasingly aim for their projects to obtain one of the sustainability certifications, such as BREEAM or LEED'.

David believes that while the EU and EBRD funding has been gradually increasing, it has been mostly channelled towards public buildings and refurbishments. He expects private funding to continue playing a critical role in supporting an overdue wave of new construction in the region, with focus on modern sustainable buildings. «

- Energy efficiency projects in CESEC region have improved supply market integration and strategic supply infrastructure.
- Demand side initiatives have remained underfunded with public funds focusing on upgrading public buildings. Private funding plays a critical part in new sustainable construction.
- The legal framework for new construction has caught up with modern standards, partly through pressure from stakeholders who increasingly require more sustainable buildings, according to David Allen of Chayton Capital.

- 1 Mario Tanev, 'EBRD invests 100 mln euro in Bulgaria's BEH 7-yr bond', August 2018 <https://seenews.com/news/ebrd-invests-100-mln-euro-in-bulgarias-beh-7-yr-bond-622495>
- 2 Buildings Performance Institute, Financing the future of buildings in Central, Eastern and South-East Europe, 2017
- 3 European Commission, 'Guide on good practice in energy efficiency for Central and South Eastern Europe', 2018
- 4 World Bank Group/GFDRR, 'Europe and Central Asia - Country Risk Profiles for Floods and Earthquakes', May 2016
- 5 Georgescu et al., Seismic and Energy Renovation. A Review of the Design Approach in Italy and in Romania, Sustainability, May 2018

This article was written by Anjelika Klamp, CFA, Managing Director at CITE Investments.