

FUTURE CITIES SERIES: SMART JOINT VENTURES AND THE CLIMATE CHALLENGE

02 June 2021 | Insight

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With Covid-19 and climate change targets set to drive dramatic change in property use, we explore smarter ways to deploy city real estate.

Great change is on the horizon for the real estate industry and the market players investing in real estate – but in many instances it is not certain in what shape or form such change will materialize. The impact of the Covid-19 pandemic will almost certainly change the way in which individuals occupy buildings, in particular office space. At the same time ESG, in particular the environmental aspects, will become increasingly more relevant. Buildings and construction constitute 40% of global carbon emissions, and plans to get this number to zero are becoming more ambitious at a rapid rate.

This article is part of our Future Cities Series where our experts explore the pressures facing our cities in the post-Covid era and map out the key issues and industry themes in re-thinking urban life.

Real estate investors must consider how they can address these issues in a cost efficient way, in particular regarding aged real estate where the need for corresponding alterations is most substantial and hence expensive, and where existing lease agreements may not give the landlord the right to force the tenant to contribute to the costs incurred.

At first glance, a rather unremarkable provision introduced in Germany may give an indication regarding the direction of travel for managing the costs of ESG compliance. This provision was included in the German law on energy efficiency which came into force on 1 November 2020 and was required at a national level as a result of the European directive on energy efficiency implemented at the end of 2018. An "innovation clause" stipulated in sec. 103 para. 3 of the law changes the process of assessing buildings to improve energy efficiency from an individual building approach, to rather looking at a complex of buildings, as a quarter.

The general idea behind the provision is simple and best demonstrated by an example: the hull of a building and its energy supply jointly determines its energy efficiency and sustainability. When assessing each building individually, the only option of the individual owners seems to be to massively insulate the hull - at a very substantial cost. However, when a group of real estate owners join forces, they may be able to establish an energy supply of the quarter eg via geothermal energy, thereby substantially reducing the costs of the individual insulation and potentially the overall costs incurred, also.

This concept of sharing energy supply can be applied to a multitude of challenges faced by existing and to-be-constructed buildings and is applicable in any jurisdiction. It does require, however, that the applicable law allows for flexible solutions and does not impose energy efficiency requirements strictly on individual buildings. The innovation clause does exactly that: while still imposing certain standards regarding the assessment of energy efficiency at the level of each individual building, such standards are materially more flexible in case of a complex of buildings where the owners have entered into a corresponding agreement and all of the buildings on average fulfil the strict standards in principle imposed by the law. This clause - which is applicable with respect to refurbishment measures to existing buildings - is complimented by sec. 107 which allows the same type of agreements among real estate owners located in the same quarter with respect to energy supply.

One question that immediately comes to the mind, among other things, is what happens in the event of disposal of an asset. Is the new owner bound by the agreement also and if not, does this render the agreement among the remaining owners void? The new German law gives very little guidance regarding the details of the agreements to be entered into by the owners. Furthermore the law is silent on the consequences of one of the parties failing to live up to its obligations under the agreement. In the case such owner makes detrimental alterations to its building does that lead to non-compliance of the entire quarter?

Despite there being open questions, one can, however, imagine that such agreements, which categorises as smart city joint venture agreements, may go a long way to improving sustainability in a cost effective way and potentially even improve citizens quality of life in the city.

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