

Response by email to: dp21-04@fca.org.uk

7 January 2022

Response to FCA DP21/4 Sustainability Disclosure Requirements (SDR) and investment labels

We, the Association of Real Estate Funds¹ (AREF) welcome the opportunity to respond to the FCA's consultation on Sustainability Disclosure Requirements (SDR) and investment labels. As a Special Member of The IA we would like to confirm our support for their response to this consultation. Below, we would like to provide some additional feedback regarding the real estate asset class and funds.

FCA Approach

We note that the FCA plan to base entity and product-level disclosure requirements on the TCFD-aligned disclosure requirements within PS21/24 but widen the scope beyond climate to other sustainability factors. We are supportive of the FCA using TCFD as a basis for its proposed sustainability disclosure requirements as this will assist in ensuring, as far as possible, there is harmonisation of global sustainability reporting. This is important in limiting the additional burden for firms but ensuring some consistency for investors too.

We understand from the TCFD Secretariat that the TCFD:

- is looking to incorporate results of a consultation on a small set of "cross-industry, climate-related" metrics into TCFD guidance 'TCFD for real assets investors' dated 27 April 2021²;
- is not a standard setter so is not developing industry-specific metrics (including metrics for the real estate asset class and funds); and
- encourages initiatives in different industries to develop industry-specific metrics. For example, the TCFD Secretariat has kindly socialised in their Knowledge Hub presentation slides and recording of a 1st September 2021 webinar jointly hosted by AREF, Investment Property Forum (IPF) and the European Association for Investors in Non-Listed Real Estate (INREV) that considers their responses to CP21/17 and appropriate real estate metrics³.

In the context of developing industry-specific metrics, we very much welcome the opportunity for our real estate/real estate industry to influence the new SDR regulatory regime and ensure that robust, consistent and transparent metrics applicable to real estate are adopted and "*as consistent as possible with SFDR, while reflecting the needs of the UK market*".

We very much endorse the approach to consistency with SFDR indicated in paragraph 1.8 DP21/4, and in applying this approach to the real estate sector. However, we note that our members have concerns regarding the SFDR real estate indicators and the disharmony between SFDR and the EU Taxonomy; these have been set out in Annex 1. We would look for the FCA rules to be flexible and to be appropriately updated (in light of the continuing industry-regulator dialogue at both a UK and international level) to ensure any advancements in measuring sustainability, as well as technology and the availability of data, can be accommodated and these are appropriate for real estate investments.

¹ The Association of Real Estate Funds represents the UK real estate funds industry and has around 60-member funds with a collective net asset value of more than £72 billion under management on behalf of their investors, including £18 billion on behalf of retail investors in the UK. The Association is committed to promoting transparency in performance measurement and fund reporting through the AREF Code of Practice, the AREF/IPD UK Quarterly Property Funds Index and the AREF/IPD Property Fund Vision Handbook

² <https://www.unpri.org/infrastructure-and-other-real-assets/tcfd-for-real-assets-investors/7495.article>

³ <https://www.tcfhub.org/resource/real-estate-metrics-responding-to-the-uk-financial-conduct-authority-consultation-slides/>,

<https://www.tcfhub.org/resource/real-estate-metrics-responding-to-the-uk-financial-conduct-authority-consultation/>

We are pleased to note that in PS21/24 you appreciate *“Given some differences in the calculation methodologies between the TCFD’s recommendations and the EU SFDR – to which some UK firms are subject for their EU business – we proposed that metrics be calculated according to both the TCFD and SFDR methodologies. This would promote consistency of disclosures both across the EU and internationally.”*

We consider the most effective route to achieve these goals will be for the FCA to support industry adopting self-regulation and best practices in sustainability reporting; and in parallel that industry looks to:

- work collaboratively with other industry organisations (in the UK and elsewhere), investors, asset managers, occupiers and other stakeholders in creating best practice benchmarks; and
- assist the FCA and other regulators in understanding what the sector requires for best practices, with the request that the FCA endorses such best practices.

We also recognise that there are key challenges for our real estate/real estate industry: holistic measurement, credible data as well as continuing and efficient industry-regulator dialogue.

In our responses to FCA CP21/17 we proposed the use of CRREM, which is free and open source, as we believe this is currently the best tool available for measuring climate-related metrics for real estate. (Please see the paper, drawn up by AREF and IPF with the assistance of CBRE in Annex 2 to this response). We are pleased that in PS21/24 you recognise that *“firms may wish to refer to sector-specific guidance or best practice to determine which other metrics to disclose. For example, respondents engaged in real estate investment activity pointed to the Global Real Estate Sustainability Benchmark metrics and the Carbon Risk Real Estate Monitor tool.”*

We refer you to the text in the TCFD guidance ‘TCFD for real assets investors’ dated 27 April 2021 headed ‘Metrics considerations in real assets investing’ which helpfully refers to the Carbon Risk Real Estate Monitor (CRREM) tool and states:

“Are available metrics and tools appropriate for use in different real assets sectors?”

In general, the real estate sector has a better level of data quality and availability, more sophisticated tools and more refined approaches when selecting and calculating metrics. For example, transition pathways, such as CRREM, have only really been developed for the real estate sector to date, with the infrastructure, agriculture and timberland sectors all lagging in this respect. In many cases, the data availability and quality are considered too poor to be able to calculate or use similar pathways with great confidence.”

However, as stated above, we would look for FCA rules to be flexible and appropriately updated (in light of continuing industry-regulator dialogue) to ensure any advancements in measuring sustainability, as well as technology and the availability of data, can be accommodated.

We are pleased to be engaging with the FCA and the Department of Work & Pensions (DWP) in early 2022 regarding climate-related metrics for real estate assets. We propose that this engagement extends to a broader range of sustainability disclosures, being proposed by the FCA and DWP, to ensure they are aligned for real estate. We welcome statements in PS21/24 that you *“have worked with DWP to ensure broad consistency in the development of our respective TCFD-aligned rules. [You] continue to work with DWP, BEIS and other policy makers internationally to support the flow of consistent information along the investment chain.”*

In our response to CP21/17, we noted our concerns regarding the data gap and reporting using proxy data or assumptions. We are pleased that in PS21/24 you *“recognise that there may be data and methodological challenges, gaps and constraints, at least initially, in compiling the TCFD disclosures”*. Assumptions still need data to support them and the data and results are likely to be unreliable and not comparable. Also, firms can use assumptions to their favour which makes the output questionable and meaningless. We suggest the FCA engages with appropriate trade bodies, such as AREF, to solve data issues for real estate and in the provision of guidance to ensure there is consistency in the type of data or assumptions used.

Labels

We agree that there should be consistency in product labelling for sustainability. However, we would ask the FCA to take into account any unintended consequences that their proposed labelling would have on enabling firms and funds

to correctly disclose their level of sustainability for real estate assets, and the associated barriers to market that this may have on real estate firms.

In the discussion paper, there is an indicative mapping of the proposed categories to SFDR (3.12). We would like to point out that the mapping only works from the proposed SDR categories to SFDR and not in reverse. To be more precise;

- 'Not promoted as sustainable' product category is mapped with SFDR Article 6 products. However, Article 6 is broader than the FCA's categorisation and can include products with ESG risk integration which sits under the 'Responsible' product category;
- The category for 'Responsible' products is mapped with SFDR Article 8, however it could also be an SFDR Article 6 product (i.e. integration of sustainability risks into investment decisions),
- The category for Sustainable 'Transitioning' products is also mapped with SFDR Article 8,
- Similar to the previous points, Article 9 products can translate to either 'Aligned' or 'Impact'.

Therefore, if a fund is already categorised under SFDR Article 8 it could be either 'Responsible' or Sustainable 'Transitioning' under the proposed classification for SDR. Similar examples can be given for Article 6 and Article 9 products. This could cause confusion, particularly for investors, so we request that in the final rules and guidance there is more detailed clarity regarding how the SDR categories are aligned to, and consistent with, SFDR. Clients investing in both EEA and the UK will want to understand this so they can compare products.

For real estate the Sustainable 'Transitioning' category may not actually equate to Article 8 in SFDR – it may be more relevant for Article 9. For example, an investment strategy may be aimed at acquiring 'brown' buildings with the specific purpose of investing into those buildings to improve their environmental performance so that they are Taxonomy aligned. At any one point in time, this strategy may have a low proportion of Taxonomy aligned assets but should be categorised as Sustainable 'Impact' or Article 9.

We would note, as well, that the focus is largely shifting away from just the financial product categories (whether Article 8 or Article 9 SFDR) and towards the question of whether or not the financial product makes sustainable investments, in which proportions and with what objectives. This change of focus is aligned with the revisions to the MiFID delegated acts published on 4 June 2021 requiring that the sustainability preferences of end investors be assessed as part of suitability assessments, notably in terms of a minimum percentage of sustainable investment by the financial product (among other factors).

Taxonomy enables investors to assess greenness of a product. It is difficult to find data or validate data for real estate to show alignment with the EU Taxonomy which means that "sustainable" assets cannot meet the criteria. (We have provided more details on this in Annex 1 to this response.) For example, a socially focused "Article 9" fund cannot align itself to the EU Taxonomy. We would ask the FCA to keep this in mind when looking at any alignment with the UK Taxonomy; we would not want the bar to be set so high that real estate funds could not meet the criteria for an appropriate category.

We note that the FCA is considering an entity level standard threshold for "sustainability" products to evidence a firm's credentials under existing frameworks such as the FRC UK Stewardship Code 2020 and a firm's rating under the UN Principles for Responsible Investment's (PRI's) assessment. We support the aim of the FCA to ensure that a firm's own approach is consistent with the product's aims; however, we would ask for proportionality in this approach. Currently, many investors in real estate funds invest globally and are looking for consistency in reporting. For this reason, they usually check that real estate fund managers are signatories of UN PRI rather than local stewardship codes such as the one in the UK. We would not want firms, with funds in several jurisdictions, having to tie up resources interpreting and reporting on different stewardship frameworks and having less time to achieve the aim of improving their sustainable investing. Although the UK Stewardship Code 2020 can be applied across multi-asset classes, it is acknowledged that this is more challenging for non-equity assets. This can make it more onerous and time-consuming for fund management houses with real estate funds to confirm they meet the requirements to become signatories to the Code, particularly small firms with limited resources. AREF plans to work with the FRC and IA on producing guidance for our members on how they can show they are meeting the standards of the UK Stewardship

Code. We will look at how this can be incorporated into our own Code of Practice for AREF members. In addition, we would like to engage with the FCA to ensure there is some flexibility and proportionality in the entity-level requirements, particularly for firms that do not manage equity products.

The use of 'responsible' to refer to an entity level approach seems sensible. Similar to SFDR, there are strict rules around the use of 'impact' or 'sustainable' in fund names (or derivatives thereof), however we don't believe SFDR makes reference to this type of vocabulary usage at entity level. Defining entity level can be a little challenging, so it should be borne in mind that defining entity can pose problems and could provide loopholes for managers.

Disclosures

We understand the FCA is keeping in mind sustainability disclosures requirements that firms have to abide by in other jurisdictions such as the EU's SFDR. Sustainability is very important to real estate and we would ask the FCA to ensure that their disclosure requirements are relevant for this asset class.

It has been proposed in the consultation that retail consumers are provided with key product-level information and institutional investors and other stakeholders receive more detailed disclosures at product and entity level on sustainability risks, opportunities and impacts. We would ask that there is the option to provide retail consumers with the more detailed layer 2 disclosures, if appropriate, upon request.

We would also suggest that the disclosure at entity and product level for institutional investors should align fairly closely with TCFD. The FCA should refrain, as much as possible, from adding lots of other requirements as this will be burdensome for fund managers in the UK compared to other jurisdictions. The FCA should assess the benefits to investors of any additional requirements. For example, investors investing beyond the UK would probably only pay attention to metrics common to the jurisdictions they invest in and ignore the additional requirements.

We have heard from AREF Investor Members that they would like to see some independent third-party verification of product-led disclosures to eliminate greenwashing. However, we would ask that verification is proportionate, undertaken by firms or consultants with suitable expertise and is not too costly and bureaucratic for fund managers.

Many institutional investors invest in real estate via funds. It is therefore important that the information that funds are required to provide to their investors is consistent with what the investors require for their disclosures. It is important that the information provided is sufficiently consistent that investors can aggregate results from different products within an assets class, and aggregate the results from different asset classes. DWP is currently undertaking a consultation on the rules to apply to occupational pension schemes. We understand that the FCA is co-ordinating discussions with the DWP on this, which we strongly support.

Further engagement

If you would like to discuss our response with us, please contact either myself (prichards@aref.org.uk) or Jacqui Bungay (jbungay@aref.org.uk), Policy Secretariat at AREF. We welcome ongoing engagement with the FCA and, where appropriate Government, to ensure sustainability disclosure requirements in the UK are appropriate for real estate assets and funds. Please note that we will be able to contribute to the Disclosures and Labels Advisory Group (DLAG) through the IA's representatives on the Group. Also, as our members invest in real estate and other real assets for various types of open-ended and closed-ended funds, in the UK and in other jurisdictions, we are always willing to assist the FCA by sharing this wealth of knowledge and expertise.

Yours sincerely



Paul Richards
Managing Director, The Association of Real Estate Funds

Annex 1

SFDR INDICATORS APPLICABLE TO INVESTMENTS IN REAL ESTATE ASSETS

The “Principle adverse sustainability impact statement” for financial market participants holding real estate must include the 2 universal mandatory indicators for real estate in Table 1 and at least one of the additional indicators, relating to real estate, in Table 2 of the ESA’s final report. This data must be gathered quarterly from 1 January 2022 and then from 2023, by 30 June each year, the average of the quarterly data from the previous year must be published. If there are any challenges collecting the data it should be done on a best endeavours’ basis.

TABLE 1 - PRINCIPAL ADVERSE SUSTAINABILITY IMPACTS STATEMENT

Adverse sustainability indicator		Metric	Definitions
Fossil fuels	17. Exposure to fossil fuels through real estate assets	Share of investments in real estate assets involved in the extraction, storage, transport or manufacture of fossil fuels	
Energy efficiency	18. Exposure to energy-inefficient real estate assets	Share of investments in energy-inefficient real estate assets	(28)

Require **impact** (year n and year n-1); **explanation** and **action taken**

DEFINITION (28)

Inefficient real estate assets means the real estate assets calculated in accordance with the following formula and where ‘nearly zero-energy building (NZEB)’, ‘primary energy demand (PED)’ and ‘energy performance certificate (EPC)’ shall have the meanings given to them in Article 2(2)¹, (5)² and (12)³ respectively of Directive 2010/31/EU of the European Parliament and of the Council (26) (Energy performance of buildings):

$$\frac{(\text{Value of real estate assets built before 31/12/2020 with EPC of C or below}) + (\text{Value of real estate assets built after 31/12/2020 with PED below NZEB in Directive 2010/31/EU})}{\text{Value of real estate assets required to abide by EPC and NZEB rules}}$$

¹ ‘nearly zero-energy building’ means a building that has a very high energy performance, as determined in accordance with Annex I. The nearly zero or very low amount of energy required should be covered to a very significant extent by energy from renewable sources, including energy from renewable sources produced on-site or nearby.

² ‘primary energy’ means energy from renewable and non-renewable sources which has not undergone any conversion or transformation process;

³ ‘energy performance certificate’ means a certificate recognised by a Member State or by a legal person designated by it, which indicates the energy performance of a building or building unit, calculated according to a methodology adopted in accordance with Article 3.

CONCERNS WITH DEFINITION (28)

The definition for inefficient real estate assets is overly complicated and unworkable.

Not all parts of the EU have enacted NZEB, and NZEB and EPC is defined differently across Europe.

Non-EU real estate assets may not use terms like EPC's, PED or NZEB. It says at the bottom of the formula that the value of assets that "are required" by NZEB or EPC should be included. It is unclear whether assets that do not use EPC / NZEB measurements would be excluded from the formula. If that is the case the formula is meaningless if not all assets are included.

It is unclear what happens to developments that are completed after 31/12/2020 but do not have NZEB as it didn't exist when the building was designed. These types of buildings will be classified as being inefficient but are probably more energy efficient than older buildings.

EPC are provided for a 10-year period. Fund managers sometimes have to rely on the tenant for the EPC which means it may be challenging to obtain the most current EPC for the building.

By saying that EPC are required for buildings built before 31/12/2020 and NZEB required for funds built after 31/12/2020 implies NZEB would be replacing EPC over time. It was believed that EPC would be continuing so we do not understand why are they only used for buildings before 31/12/2020.

TABLE 2 - ADDITIONAL CLIMATE AND OTHER ENVIRONMENT-RELATED INDICATORS

Adverse sustainability impact	Adverse sustainability impact (qualitative or quantitative)	Metric	Definitions
	18. GHG emissions	Scope 1 GHG emissions generated by real estate assets	(1), (2)
		Scope 2 GHG emissions generated by real estate assets	
		From 1 January 2023, Scope 3 GHG emissions generated by real estate assets	
		Total GHG emissions generated by real estate assets	
Energy consumption	19. Energy consumption intensity	Energy consumption in GWh of owned real estate assets per square meter	(14)
Waste	20. Waste production in operations	Share of real estate assets not equipped with facilities for waste sorting and not covered by a waste recovery or recycling contract	(21) ¹

Resource consumption	21. Raw materials consumption for new construction and major renovations	Share of raw building materials (excluding recovered, recycled and bio-sourced) compared to the total weight of building materials used in new construction and major renovations	
Biodiversity	22. Land artificialisation	Share of non-vegetated surface area (surfaces that have not been vegetated in ground, as well as on roofs, terraces and walls) compared to the total surface area of the plots of all assets	

¹ 'recycling' means any recovery operation by which waste materials are reprocessed into products, materials or substances whether for the original or other purposes. It includes the reprocessing of organic material but does not include energy recovery and the reprocessing into materials that are to be used as fuels or for backfilling operations.

DEFINITION (1)

'scope 1, 2 and 3 GHG emissions' means the scope of greenhouse gas emissions referred to in subpoints (i) to (iii) of point (1)(e) of Annex III of Regulation (EU) 2016/1011 (EU Climate Transition Benchmarks, EU Paris-aligned Benchmarks and sustainability-related disclosures for benchmarks):

- (i) Scope 1 carbon emissions, namely emissions generated from sources that are controlled by the company that issues the underlying assets;
- (ii) Scope 2 carbon emissions, namely emissions from the consumption of purchased electricity, steam, or other sources of energy generated upstream from the company that issues the underlying assets;
- (iii) Scope 3 carbon emissions, namely all indirect emissions that are not covered by points (i) and (ii) that occur in the value chain of the reporting company, including both upstream and downstream emissions, in particular for sectors with a high impact on climate change and its mitigation;

DEFINITION (2)

'greenhouse gas (GHG) emissions' means greenhouse gas emissions as defined in point (1) of Article 3 of Regulation (EU) 2018/842 of the European Parliament and of the Council (Binding annual greenhouse gas emission reductions by Member States from 2021 to 2030 contributing to climate action to meet commitments under the Paris Agreement):

- (1) 'Greenhouse gas emissions' means emissions in terms of tonnes of CO₂ equivalent of carbon dioxide (CO₂), methane (CH₄), nitrous oxide (N₂O), hydrofluorocarbons (HFCs), perfluorocarbons (PFCs), nitrogen trifluoride (NF₃) and sulphur hexafluoride (SF₆) ...

CONCERNS WITH ADDITIONAL CLIMATE AND OTHER ENVIRONMENT-RELATED INDICATORS

18. GHG emissions

It will be difficult to obtain tenant data for GHG Scope 3; estimations may have to be used. Also, when acquiring an asset, there was always a delay in obtaining the data.

Energy consumption - 19. Energy consumption intensity

It is unclear whether the occupier's energy intensity be included.

There would hasn't been a consistent approach across jurisdictions for measuring the area occupied by the asset. RICS published in January 2018 a [global standard for property measurement](#). NIA / GLA data calculated prior to 2018 and used to calculate energy intensity will create variation. It is understood there has been a global discrepancy in areas up to 24% prior to this global standard being defined.

Waste - 20. Waste production in operations

It is unclear whether this is landlord-controlled waste or it includes tenants waste.

This will be difficult to calculate the share of real estate assets not equipped with facilities for waste sorting and not covered by a waste recovery or recycling contract.

Resource consumption - 21. Raw materials consumption for new construction and major renovations

Material used on site is not currently weighed; this is going to cause additional work especially as materials are sourced from different suppliers. Guidance is required on how the weight of materials is expected to be measured.

A definition for "major renovations" is required.

Biodiversity - 22. Land artificialisation

It will be a challenge to obtain this information; the surface area of the plot of assets is not currently measured so this would have to be estimated.

More clarity is required. For example, it is unclear whether this includes vertical surfaces such as green walls

EU TAXONOMY & SFDR – APPLICATION TO REAL ESTATE (“RE”) FUNDS

Introduction:

RE funds which are assessed and classified under the SFDR framework are, as of 1 January 2022, also required to report on alignment with the EU Taxonomy. This requires managers to evaluate and report on two separate frameworks, which do not work in harmonisation and require the application of different criteria, none of which was designed with RE investments in mind.

EU Taxonomy & RE:

EU Taxonomy	Application to RE
<p>1. Substantially contributes to one or more of the following objectives:</p> <ul style="list-style-type: none"> A. climate change mitigation; B. climate change adaptation; C. the sustainable use and protection of water and marine resources; D. the transition to a circular economy; E. pollution prevention and control; or F. the protection and restoration of biodiversity and ecosystems 	<p>Only 1A and 1B are applicable to RE Funds:</p> <ul style="list-style-type: none"> - Climate Change Mitigation - Climate Change Adaptation
<p>2. Does not significantly harm (“DNSH”) the environmental objectives listed in Section 1 above and in accordance with Article 17 EU Taxonomy Regulation the activity:</p> <ul style="list-style-type: none"> A. does not lead to significant greenhouse gas emissions; B. does not lead to an increased adverse impact of the current climate; C. is not detrimental to the good status or the good ecological potential of bodies of water; D. does not lead to inefficiencies in the use of materials or in the direct or indirect use of natural resources; E. does not lead to a significant increase in the emissions of pollutants into air; and F. is not significantly detrimental to the good condition and resilience of ecosystems. 	<p>As per the above, only 2A and/or 2B can be applicable to RE funds (as this follows from Row 1 above).</p> <p>Measuring 2A or 2B with reliable, supportable and consistent metrics or benchmarks that are comparable across RE Funds is fundamentally challenging across the European Union.</p> <p>Additionally, there is no guidance on the definitions applicable to each criteria, the base line level applicable or the specific metric or benchmark to be applied when testing the criteria, making assessment and reporting challenging and subjective.</p>

<p>3. Uses minimum safeguards – including the use of the procedures implemented by an undertaking that is carrying out an economic activity to ensure the alignment with the OECD Guidelines for Multinational Enterprises and the UN Guiding Principles on Business and Human Rights.</p>	<p>This criteria is aimed at equity investments in corporate vehicles and accordingly it is difficult to find alignment with a RE investment.</p> <p>Hopefully this will be resolved by extending the EU Taxonomy to social objectives.</p>
<p>4. Complies with technical screening criteria that have been established by the European Commission</p>	<p>Different for each objective described and until now adopted in relation to the environmental objective qualifying as (i) climate change mitigation, or (ii) climate change adaptation</p> <p>The technical screening criteria are not static which creates challenges for real estate assets.</p>

Commentary:

A Fund will only be in scope of the EU Taxonomy Regulation and, therefore, be obliged to make disclosures required thereunder when all four of the above criteria are cumulatively satisfied. However, these criteria are more aligned with equity investment as opposed to real estate.

Whilst SFDR applies at an investment level and includes environmental and social objectives, the EU Taxonomy assessment looks through and considers the sustainability of the underlying investment from an environmental perspective only. As a result, two difference assessments with different underlying criteria are required to be performed in relation to any product.

In relation to reporting for a product, SFDR periodic reporting on fund objectives applies to reports delivered from 1 January 2022. EU Taxonomy alignment is included as a part of the reporting, but as a large number of RE funds have non-environmental objectives they have no alignment with EU Taxonomy. This therefore leads to a potential perceived inconsistency from a market perspective where there is a wholly sustainable Article 9 fund which explicitly states it is not aligned with EU Taxonomy.

The piecemeal implementation of SFDR and EU Taxonomy, along with the lack of harmonisation across the legislative requirements combined with the lack of focused guidelines and application to real estate and the built environment has led to a number of frustrations and complications in relation to the SFDR classification and reporting for RE funds.

Accordingly, with SDR, we have an opportunity to produce sector specific criteria, guidelines and metrics and harmonise the application of SDR, TCFD and UK Taxonomy to ensure meaningful and measurable classification and reporting for RE funds, ultimately enabling investors to assess and compare RE funds on the same basis. We would be delighted to work with the FCA on the RE framework and specific metrics applicable to RE.

Some initial headline points to be taken into consideration:

- Harmonisation with SFDR to (as far as possible) create consistency for Funds and Investors in relation to:
 - Classification
 - Reporting obligations (content and timing)
 - Metrics
- Labelling: applicability and application to RE
- RE metrics:
 - TCFD recommendations
 - Availability of data and equivalent comparisons
- Benchmark/Sustainability Standards – sector specific, industry recognised standards, which allow year-on-year data to be captured, measured and reported and progress documented in standardised manner, allowing appropriate comparison across RE funds. Current proposals include using GRESB and CRREM, others also to be considered.
- Conformance/consistency with ISSB and assistance with developing the ISSB framework.

Annex 2

Metrics for Commercial Real Estate (“CRE”) – Alignment in response to FCA CP21/17.

What is proposed

The metrics proposed in FCA CP21/17 follow the TCFD recommendations, which were based on funds investing in equities. They don't have strong alignment with real estate, and include metrics which are not standard for real estate reporting. AREF, IPF and other industry trade bodies welcome the opportunity to influence the outcome and provide more aligned and relevant metrics for the reporting of climate related impacts and resilience to stakeholders.

ESG 2 Annex 1 TCFD Product Report Metrics

	TCFD (see page 43 of the TCFD Final Report)	SFDR (please see annex I of the draft RTS)
Weighted average carbon intensity (WACI)	Portfolio's exposure to carbon-intensive companies, expressed in tons CO ₂ e / \$M revenue. <i>Metric recommended by the Task Force.</i> $\sum_n \left(\frac{\text{current value of investment}_i \times \text{issuer's Scope 1 and Scope 2 GHG emissions}_i}{\text{current portfolio value} \times \text{issuer's \$M revenue}_i} \right)$	$\sum_n \left(\frac{\text{current value of investment}_i}{\text{current value of all investments (€M)}} \times \frac{\text{investee company's Scope 1, 2 and 3 carbon emissions}_i}{\text{investee company's €M revenue}_i} \right)$
Total carbon emissions	The absolute greenhouse gas emissions associated with a portfolio, expressed in tons CO ₂ e. $\sum_n \left(\frac{\text{current value of investment}_i}{\text{issuer's market capitalization}_i} \times \text{issuer's Scope 1 and Scope 2 GHG emissions}_i \right)$	$\sum_n \left(\frac{\text{current value of investment}_i}{\text{investee company's enterprise value}_i} \times \text{investee company's Scope 1, 2 and 3 carbon emissions}_i \right)$
Carbon footprint	<i>Description</i> Total carbon emissions for a portfolio normalized by the market value of the portfolio, expressed in tons CO ₂ e / \$M invested. <i>Formula</i> $\sum_n \left(\frac{\text{current value of investment}_i \times \text{issuer's Scope 1 and Scope 2 GHG emissions}_i}{\text{current portfolio value} (\$M)} \right)$	$\sum_n \left(\frac{\text{current value of investment}_i}{\text{investee company's enterprise value}_i} \times \text{investee company's Scope 1, 2 and 3 carbon emissions}_i \right) / \text{current value of all investments (€M)}$
Scope 1, 2 and 3 GHG emissions, disclosed separately	Scope 1 refers to all direct GHG emissions. Scope 2 refers to indirect GHG emissions from consumption of purchased electricity, heat, or steam. Scope 3 refers to other indirect emissions not covered in Scope 2 that occur in the value chain of the reporting company, including both upstream and downstream emissions. Scope 3 emissions could include: the extraction and production of purchased materials and fuels, transport-related activities in vehicles not owned or controlled by the reporting entity, electricity-related activities (eg, transmission and distribution losses), outsourced activities, and waste disposal (see page 63 of the TCFD Final Report).	The scope 1, 2 and 3 definitions are contained in the low carbon benchmark regulation: (i) Scope 1 carbon emissions, namely emissions generated from sources that are controlled by the company that issues the underlying assets; and (ii) Scope 2 carbon emissions, namely emissions from the consumption of purchased electricity, steam, or other sources of energy generated upstream from the company that issues the underlying assets. (iii) Scope 3 carbon emissions, namely all indirect emissions that are not covered by points (i) and (ii) that occur in the value chain of the reporting company, including both upstream and downstream emissions, in particular for sectors with a high impact on climate change and its mitigation.

How these indicators align with traditional reporting in CRE:

Indicator	Achieves	Alignment with CRE Reporting
WACI	Relative intensity of investment	Equity share approach is not common, nor is the use of revenue or rental income as an intensity metric.
Total Carbon Emissions	Footprint of the share of investment	Equity share approach is not common in CRE, as operational control approach is more relevant.
Carbon Footprint	Intensity of the share of the investment by value	CRE typically considers Floor Area as a denominator
Scope 1-3 breakdown	Actual footprint	This is aligned and should include Scope 3 and sum to the Total Carbon Emissions. Without Scope 3 tenant emissions, the footprint is not an accurate assessment of risk. Real estate funds should be developing Scope 3 reporting of embodied carbon into this metric as well.
Carbon VaR	Value threatened by BAU	Should be adopted using CRREM tool
Climate Warming Scenario or Implied Temperature Rise	Comparable indicator of climate risk across asset classes	This is an overlooked metric, but makes sense to be adopted – could be integrated into CRREM.

Considerations for real estate funds regarding the proposed metrics

Greenhouse Gas Accounting Boundary Definitions

The Greenhouse Gas Protocol Boundary definition the TCFD proposes using is an equity control boundary. This is indicated by “value of investment/current portfolio value” modifier on three of the metrics. CRE is better described using the Operational Control Boundary⁴ under the GHG Protocol, which includes complete buildings in the footprint rather than the amount of equity invested. This is standard practice for INREV (European Investors in Non-Listed Real Estate) and EPRA (European Public Real Estate) reporting, as well as the definition of reporting under GRESB (Global ESG Benchmark for Real Assets). We would ask the FCA to take this into consideration to ensure consistency in reporting.

Use of Climate Risk Assessment Tools

In many cases, the tools that are used to analyse climate risk for other asset classes do not fully describe risks in CRE. How we describe transition risks and the action taken to manage these risks should be as specific to real estate as possible. CRREM (Carbon Risk Real Estate Monitor) is a tool which has been endorsed by GRESB, the IIGCC (The Institutional Investors Group on Climate Change) and NZAOA (UN-convened Net-Zero Asset Owner Alliance) among others, and adopted widely as the de facto tool for assessing climate risks at this time.

The CRREM tool provides a real estate specific assessment of climate risks and a higher quality analysis of Climate Value at Risk and other risk analyses. CRREM has the added important benefit of being open sourced and not requiring specific consultants to manage.

⁴ In this context, Operational Control refers to functions of the GHG Protocol accounting standard and is, not referring to how buildings are operated.

Summary of recommendations

The metrics developed for TCFD were designed to report across equity portfolios, and there is some misalignment with the common ESG reporting metrics used by real estate portfolios. In particular:

1. WACI would represent a large change to reporting, without sufficiently describing risks in an improved way.
2. Reporting of equity portfolios using an equity control boundary makes sense, but the more direct approach to reporting under operational control for commercial real estate makes for a more complete picture.

That said, we recognise to remain aligned with overall TCFD objectives and to participate in firm-wide reporting, that real estate fund teams will probably need to prepare these figures and have them ready for reporting to investors alongside other data.

Additional Metrics

We would recommend the following as additional metrics for CRE portfolios to include within TCFD reporting:

1. **Energy Performance Certificate (EPC) breakdown** (or comparable metrics in states not aligned with the EU's Energy Performance in Buildings Directive), in line with the EU's Sustainable Finance Disclosure Regulations (SFDR). This can include the so-called "*Inefficient Buildings*" metric of assets below and EPC of B as a key metric, and disclosing a complete breakdown of EPC ratings across the portfolio as deeper analysis of risk.
2. The **CRREM analysis of Climate Value at Risk** as a snapshot of current risks accompanied with risk mitigation narrative. CRREM is preferable to other variations of the metric available in the market as we understand it is more accurate and more commonly used than other approaches in CRE. The CRREM tool should use the 1.5C pathway (it defaults to the 2C pathway, but we recommend the 1.5C pathway which is in line with the recommendations of the Science Based Targets Initiative), and the pathway used should be clearly stated. We would advise that real estate funds provide, as well as the snapshot, a mitigation plan which is also aligned with the CRREM trajectories. The next page has considerations of how CRREM should be used.

We acknowledge that further development will be needed to the CRREM tool, and recommend that CRREM:

- Continue to develop the Climate Value at Risk metrics
- Incorporate an Implied Temperature Metric into the tool, for an aligned metric across different investment classes
- Consider improvements to the CRREM workflow, to separate climate risk assessment from the risk mitigation analyses – making it clearer what is a risk snapshot and what is a mitigation planning tool. We expand on these considerations in greater detail below.

To provide further context for the FCA of our recommendations, this section of guidance to members has been included.

Considerations for use of CRREM to manage climate resilience

The CRREM tool provides a set of climate change risk analysis tools specifically for the Commercial Real Estate sector. The tool can provide multiple outputs which can support Net Zero alignment and assessment of climate risks. The tool has the benefit of being freely available, and also pre-populated from GRESB reporting.

CRREM provides several useful analyses, which can be applied to assets to recognise future decarbonisation risks and targets, but that a more standardised approach to how the CRREM tool is used will reduce uncertainty. AREF and IPF plan to support the improved alignment across Commercial Real Estate in how CRREM is used by providing guidance to their members.

CRREM as a climate risk tool

For an assessment of an asset or portfolio's exposure to climate risk, particularly at acquisition, or as a snapshot, CRREM provides a very helpful assessment. The tool provides useful charts and insights as it stands, though more research is required to make the upgrade costs noted in the tool more relevant and complete.

CRREM for Net Zero alignment

CRREM is being used to assess Net Zero alignment, but different members will approach the tool in different ways. The WorldGBC define Net Zero as:

“A highly energy efficient building that is fully powered from on-site and/or off-site renewable energy sources and offsets.”

The challenge with CRREM is its use of Scope 2 location-based emissions factors, which are very helpful in recognising the overall climate risk of a specific asset or a portfolio. It does not, however, speak to the “on-site and/or offsite renewable energy”; the important energy procurement decisions which are vital to Net Zero. This would be calculated appropriately using Scope 2 market-based emissions factors. From a carbon emissions perspective, we believe that members should use the Scope 2 market-based emissions factors from their suppliers.

Making this adjustment, green tariffs are appropriately reported, which can make the CRREM tool's main carbon charts misleadingly optimistic. We believe that the majority of the challenge of making existing assets net zero aligned is to do with energy efficiency, and the kWh/m² pathway which CRREM provides is most helpful – until 2041.

In 2041, the CRREM energy efficiency pathways for UK offices intersect with the UKGBC's top-down Energy Use Intensity target of 70 kWh/m² (based on Net Lettable Area). From 2041, using the UK offices example, the CRREM energy targets become unrealistic and are driven by the lack of Scope 2 market-based emissions integration.

The use of location-based and market-based methodologies within the tool could be confusing, but could be presented in the light of climate risk vs net zero pathway. This needs to be considered in greater detail.