INVESTMENT INSIGHTS

UK COMMERCIAL & RESIDENTIAL REAL ESTATE

AREF
The Association of Real Estate Funds

Investing in Sustainable Buildings

July 2024

INTRODUCTION

Real estate funds and their investors recognise that buildings currently produce a high level of carbon emissions. They understand the importance of working towards ensuring the buildings they own meet net zero requirements as soon as possible, including both operational and embedded carbon, taking a whole life approach. This has to be a collaborative process with policymakers, who should consider requirements around the environment, nature and social value in a connected way.

AREF supports its members to implement sustainable practices, optimising energy performance, reducing carbon emissions and enhancing biodiversity, and lobbies government and regulators on these topics on members' behalf. AREF engages with investors and other stakeholders to raise awareness about the importance of sustainability in real estate investments and fosters a shared commitment to driving positive environmental and social impact.[1]

In partnership with other real estate related associations, AREF has assisted in developing tools and frameworks for measuring and reporting progress towards sustainability targets, enabling real estate funds to track their performance and demonstrate their commitment to sustainability. This has been set out in the ESG Metrics for Real Estate paper.[2]

HIGH SUSTAINABILITY STANDARDS ARE IMPORTANT WHEN ATTRACTING INVESTMENT IN REAL ESTATE

Sustainability is usually an important factor when real estate investors decide where to invest their capital. To attract capital from institutional investors, from within the UK and from overseas, the UK needs to have high sustainability standards compared to other countries. AREF members support the UK Net Zero Carbon Building Standard that should provide greater goalposts for buildings to aim for.[3] There must be certainty that legislation and policies will remain consistently high to ensure the UK achieves net zero by 2050. For example, investors expect real estate in the UK to adopt a net zero aligned trajectory, such as the Carbon Risk Real Estate Monitor (CRREM) pathways.

1. The Association of Real Estate Funds (AREF) represents the UK real estate funds industry and has over 50 member funds with a collective net asset value of more than £50 billion under management on behalf of their investors. These funds invest in a wide range of real estate including residential, retail, offices, industrial as well as specialist sectors such as healthcare, affordable housing, student housing, life sciences and leisure.
2. ESG Metrics for Real Estate
3. https://www.nzcbuildings.co.uk/

Many institutional investors have signed up to the UN-Convened Net Zero Asset Owner Alliance. They have committed to decarbonising their investment portfolios and achieving net-zero emissions by 2050. If they cannot achieve this by investing in the UK, they will invest elsewhere.

The aspiration of the Financial Conduct Authority (FCA) to build a world-leading and competitive sustainability regime that will help the UK's asset management sector thrive by setting standards that improve sustainability information is welcomed by real estate funds. The UK's Transition Plan Taskforce (TPT) aims to deliver a "gold standard" for climate transition plans; this is supported by real estate funds. The ESG Metrics for Real Estate paper has been mentioned in publications by the FCA and TPT. This takes a whole life carbon approach that considers scope 1, 2, and 3. It also provides recommendations on broader issues such as social value, physical and transitional risk, and biodiversity.

However, there has been a lack of direction from government surrounding key regulation such as the proposal to amend the Minimum Energy Efficiency Standards (MEES) and Energy Performance Certificate (EPC) requirements. Also, there has not been any follow up from the government to the consultation on a national performance-based policy framework for rating the energy and carbon performance of large commercial and industrial buildings. This considered implementing regulations similar to NABERS for commercial buildings over 1,000 square feet.[4]

Carbon offsetting and pricing are important tools in helping businesses to build a case for low carbon solutions. They have a role to play in accelerating the decarbonisation of the built environment. More guidance would be welcomed on future government policy on how this will be managed.

HOW ARE REAL ESTATE FUNDS SUPPORTING THE MOVE TO NET ZERO CARBON EMISSIONS?

We endorse the views expressed in the Skidmore Report in 2023 that "The private sector is critical to the net zero transition. Their investment and innovation will bring low carbon technology to the mass market. They will drive many of the benefits we will all experience from net zero, not least economic growth."

When considering improving the sustainability of a building, retrofitting is preferred over replacing a building from a whole life carbon perspective, where it is cost effective. When investing in new buildings, residential and commercial, real estate funds are expecting them to meet and even exceed the latest environmental requirements. Using modern construction methods can reduce carbon emissions; we ask for recognition in the planning process for this.

Real estate funds invest in both residential and commercial buildings for the long-term. For this reason, they want these properties to meet the highest viable standards now as it will cost more to upgrade them at a later date. In some cases, this can only be achieved if other stakeholders are encouraged to do the same. For example, house builders should continue to be encouraged to install solar panels, air source heat pumps and electric car chargers in new builds.

4. What is NABERS?

NATURAL CAPITAL IS MORE THAN NET ZERO CARBON EMISSIONS

Delivering net zero carbon emissions is an important part of investing in natural capital, but maintaining the Earth's stock of natural resources and ecosystem services is wider than that. We are supportive of regulations from UK government on biodiversity net gain and the introduction of additional planning requirements for new developments. Real estate funds are progressively measuring and assessing the ecological footprint of individual property assets to determine exposure to biodiversity risks and opportunities. Frameworks such as the Taskforce on Nature-related Financial Disclosures (TNFD) will play an important role in assessing risks and opportunities, but more needs to be done to understand common metrics suitable for real estate, credible baseline assessment and measurement tools, and industry-wide consensus on ambitious targets. This will assist real estate funds in setting short and longer-term biodiversity targets and disclosing their progress against them. Real estate funds are already gradually adopting implementation measures such as:

- Protecting, managing, and enhancing the biodiversity of sites by actively promoting the safeguarding and supervision of trees, hedgerows and shrubs, water bodies, grassland, formally planted and wildflower areas.

- Where practical, fostering the creation of new habitats by incorporating bird and bat boxes, creating and managing compost heaps and wood piles, and handling invasive species.

Other ways real estate funds could assist with natural capital is to enable them to adopt a retrofitting approach for existing buildings and collaborate with neighbouring property owners and local stakeholders as ecosystems exist beyond red line plot boundaries.

INNOVATION AND THE FUTURE

There is a place for the UK to lead on innovation to improve the sustainability of buildings. For instance, there is a need to eliminate gas consumption in homes and businesses through electrification by either installing air source pumps or, where applicable, ground source heat pumps. We agree with the views expressed in the Skidmore Report that “net zero is the growth opportunity of the 21st century” and we, in the UK, “must act decisively to seize the opportunities in a global race”.

HOW DO REAL ESTATE FUNDS SUPPORT COMMUNITIES?

Real estate funds work in partnership with local authorities and communities to provide housing, workplaces and services (for example, healthcare and educational buildings) required. This investment and the retrofitting of current buildings to meet net zero carbon requirements will provide many jobs. This will require more qualified contractors, such as engineers for installing and maintaining energy efficient products such as air source heat pumps. Local colleges and businesses should be incentivised by government to provide high-quality apprenticeships and training opportunities in the building industry to meet the skills gap. This will help provide a just transition through job creation and economic growth in the very communities often negatively impacted by the move to more sustainable practices.

New and retrofitted buildings to meet net zero carbon requirements also have a positive impact on the residents and tenants as these buildings should reduce the demand for energy consumption and hence should reduce running costs for residents and occupiers.

Additional Reading

DLUHC - Partnerships for People and Place: Guidance and advice for officials working on place-based policymaking

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