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# COP26 and Real Estate Tackling 'great inertia'

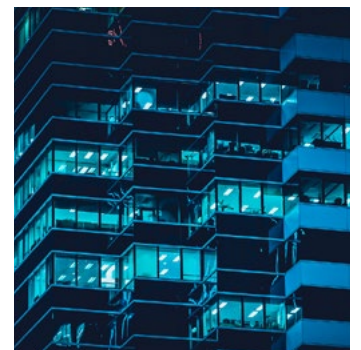
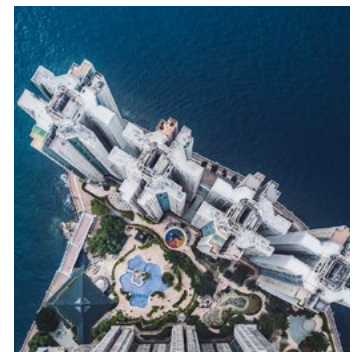
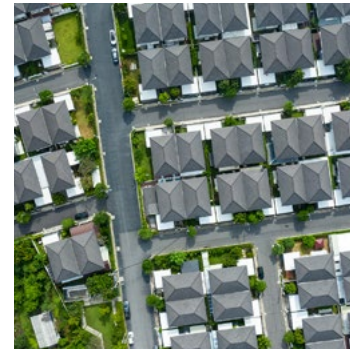
Curbing buildings' carbon emissions is one of the biggest challenges in climate change policy. Can the property industry reinvent itself for the net zero age?

11 November 2021 is Cities, Regions & Built Environment Day at the United Nations' climate conference COP26. There will be much to discuss - achieving cuts in the greenhouse gas emissions associated with buildings has proven one of the biggest unresolved challenges in combatting climate change. The Marrakech Partnership created to advance goals agreed in Paris at COP21 summed up the task: "The built environment has great inertia due to its complexity and fragmented value chain. Radical collaboration across all stakeholders at the project and sector scales is needed to find solutions that will transform it."

There has been much talk over the last decade about net zero buildings, and ambition has ebbed and flowed. Meanwhile, heating and cooling of buildings continues to give rise to

roughly 40% of global carbon emissions, and 50% of emissions in cities derive from buildings, outstripping transport. US property group CBRE points out that although the UK has cut net emissions across sectors by around 50% since 1990, transport and homes have made almost no contribution to those reductions.

However, it appears the pressure for action unleashed by the 2017 recommendations of the Task Force on Climate related Financial Disclosures has prompted the real estate sector to approach decarbonisation with renewed fervour. Might we reach a point where aging buildings - dogged by poor insulation and inefficient energy use - lose lustre with tenants and investors? Could dated, high-carbon properties become stranded assets as wider economies move to net zero?







### Valuations in the net zero age

Improvements in energy efficiency through better design and materials and ‘smart building’ technologies have the potential to reduce property running costs. Buildings may wind up being more pleasant workplaces and homes, attracting a premium rental or sale value.

The UN Environment Programme’s Finance Initiative says data from the US, Australia, France, the Netherlands and Singapore convincingly shows that financial performance of green and energy-certified offices and homes is superior and the risk of mortgage default lower compared to non-certified properties.

Research by the UK Green Building Council and property firm JLL showed that BREEAM sustainability certification was a significant variable in rental performance. BREEAM Excellent assets outperformed non-certified equivalents by more than 100%, with an average contracted rent of £47.5/ft<sup>2</sup> versus £23/ft<sup>2</sup>, while 28% of the variability in contracted rents could be attributed to BREEAM certification.

### Sustainable real estate finance

Value may be driven not just through real life savings or benefits but demand from investors and lenders. Green and sustainability-linked loans are increasingly used for property acquisitions, re-financings, development finance and to fund energy efficiency and climate change resilience improvements.

Green loans are available for buildings whose design meets selected green criteria, such as a given grade under a sustainability ratings scheme. These vary internationally with examples including BREEAM in the UK, HQE in France and DGNB in Germany. Sustainability-linked loans, meanwhile, incorporate tailored KPIs which if met trigger benefits for the borrower, such as lower interest rates.

Green lending may result in loans made to borrowers or projects that might not otherwise have been financed; there is discussion of capital adequacy requirements being relaxed for qualifying green lending, likely fuelling banks’ willingness to lend.

There is, however, no unified set of standards for what makes an individual development or real estate borrower ‘green’, leaving lenders to use their own green frameworks and criteria. Greater standardisation may come but the question arises: should driving the green

agenda be left to financial markets or tackled through regulation?

### Development control and climate change

Not every development involves external financing but the majority of new build and alterations require some planning authorisation. As such, applications for planning consent provide an opportunity to vet environmental impacts of construction, choice of location and possibly impose ongoing requirements for premises use.

In the UK, at least, a central policy framework exists to guide local authorities in planning decisions and in addition local authorities have bespoke plans. Developers are required to consider the risk of flooding, taking into account predictions of future frequency and intensity of floods due to climate change. Larger projects may also be required to conduct environmental impact assessments in which the vulnerability of the development to climate change impacts and the degree the development contributes to carbon emissions are considered.

As well as achieving improvements in environmental performance, wider ESG considerations are increasingly likely to focus developers and their supply chains, occupiers, investors and lenders on addressing cuts in embodied carbon, including via modern construction methods.

### Retrofitting building stock

It is estimated 80% of the buildings that will exist in 2050 are already built. Older building stock is typically less energy efficient and more reliant on fossil fuel heating than modern equivalents. As a rule of thumb, it is thought to be up to five times more expensive to retrofit buildings than build new energy efficient homes. But can the environmental cost of demolition and rebuilding be justified? Despite high costs, regulation may one day emerge to prioritise retrofitting over new build.

Replacing fossil fuel heating systems across the housing stock of a nation such as the UK, which is dependent on gas, is another huge challenge. Alternatives such as heat pumps, hydrogen in place of gas and electric radiators have their pros and cons.

Recent government attempts to incentivise UK homeowners to increase energy efficiency have fallen flat or been open to dishonest practices. (For other UK measures under

consideration, see our briefing on the [Ten Point Plan](#).) It is also important to avoid unintended consequences by over-insulating, risking overheated homes in the summer and compromised indoor air quality.

### Landlord and tenants – Conflicting interests

Here lies a dilemma for landlords: it is generally tenants who are in control of energy used inside premises, and if money is spent by landlords to upgrade thermal efficiency it will be the tenant who benefits from lower energy bills. Conversely, advantages of a modern building designed to the latest energy standards can be squandered by tenants wastefully using power.

So far only sporadic attempts have been made to regulate this situation consensually in green leases. These are leases that include areas on which landlord and tenant collaborate to improve environmental performance.

However, typically they have been qualified obligations only and breach does not result in remedies with teeth such as the landlord being able to terminate the lease.

Some attempts have also been made through regulation to incentivise landlords and property sellers to upgrade premises. Examples include requirements for energy audits to identify opportunities for potential improvements and obligations for certain large businesses to report their total energy use and emissions in annual accounts.

### Visions of change – Galvanising the industry

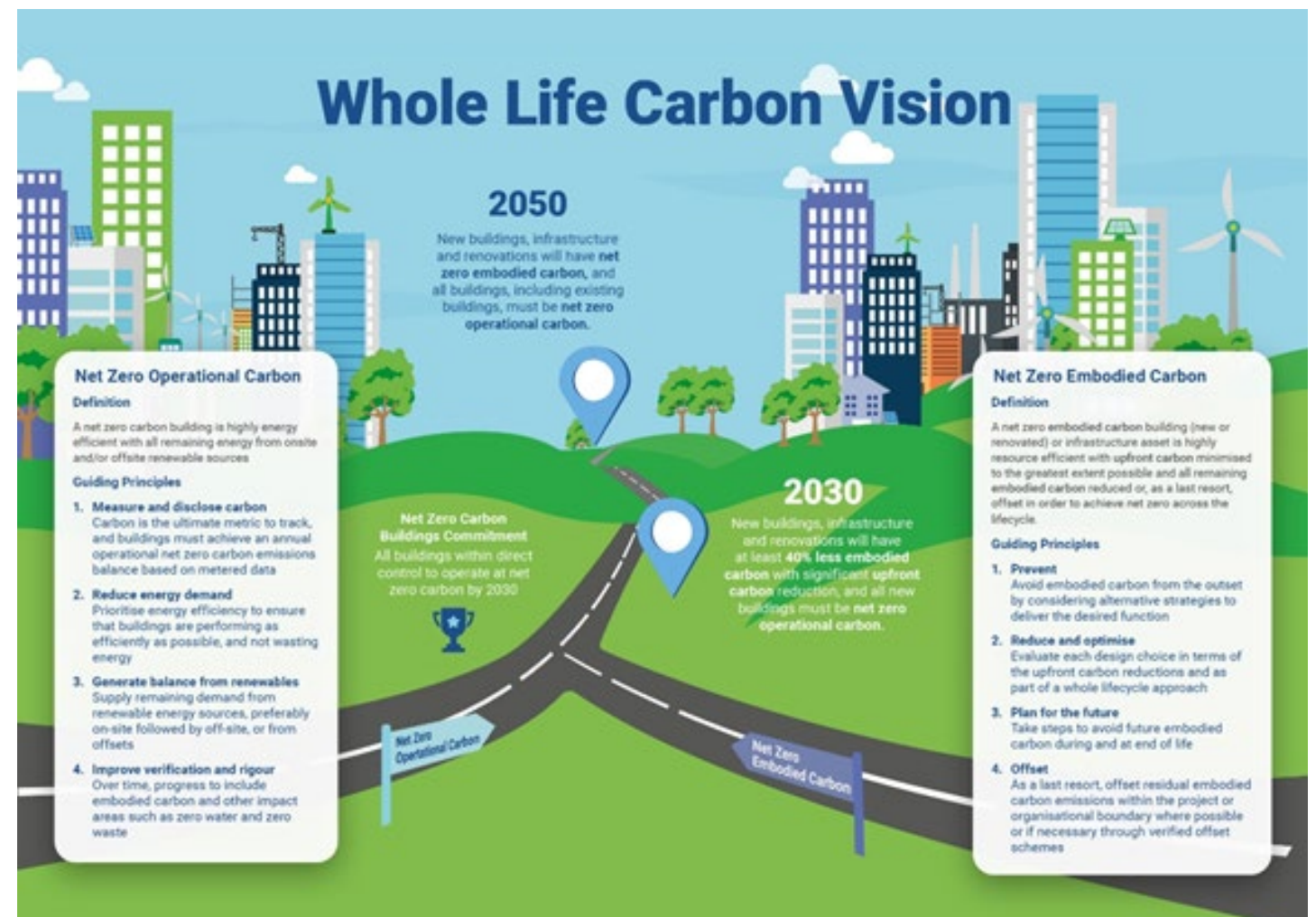
In light of the huge challenge in tackling buildings’ emissions, the real estate sector has come together with multiple initiatives to catalyse change. The World Green Building Council (WGBC) is poised to announce its Whole Life Carbon Vision at COP26. Updating earlier pledges, the new initiative uses a

lifecycle approach focusing on upfront embodied carbon in materials and construction.

Other initiatives with heavy sector backing include:

- The UN-convened Net-Zero Asset Owner Alliance
- The Net Zero Asset Managers initiative
- The Urban Land Institute Greenprint Net-Zero Goal
- The Better Building Partnership (BBP) Climate Commitment
- The Science-Based Targets initiative’s (SBTi) Net-Zero Standard

The WGBC advocates halving emissions of the building and construction sector by 2030 and total industry decarbonisation by 2050. It anticipates the need for radical cross-sector collaboration across the whole industry:



(World Green Building Council)



Signatories include 109 businesses and organisations – among them Arup, Berkeley Group, Goldman Sachs, Grosvenor, Lendlease, Lloyds Banking Group, Multiplex and Siemens – as well as 28 cities and six states and regions.

The WGBC allows signatories to develop bespoke action plans for their portfolios based on best practice principles, annually reporting their verified progress towards decarbonisation goals. The commitment focuses on operational (Scope 1 and 2 energy-related emissions) and embodied carbon emissions over which the entity has direct control (accounted for as part of Scope 3 emissions).

Members are allowed to use carbon offsets, which the WGBC acknowledges can result in greenwashing if not used effectively but believes it necessary to address a significant residual carbon impact. As the body concludes: “A transition to a fully decarbonised building and construction sector requires a complete and unprecedented migration away from fossil fuels in building operations, supply chains and construction processes.”

There is clearly a mountain to climb, which no one under-estimates. COP26 may provide an additional catalyst for the sector to tackle that ascent more quickly.

