Net Zero – An Opportunity for Real Estate

In 2019 the UK government announced a target of 'net zero' for UK greenhouse gas (GHG) emissions by 2050 following recommendations made by the Committee on Climate Change. This led to a change in legislation that came into force on 27 June 2019, which amended the Climate Change Act 2008 target of an 80% reduction in GHG emissions compared with the 1990 levels. This amendment to the Climate Change Act made the UK the first member of the G7 group of industrialised nations to legislate for 'net zero' carbon emissions.

With the operation of buildings responsible for approximately 30 percent of greenhouse gas emissions in the UK alone, DTZ Investors has taken the opportunity to highlight the importance of this commitment against the backdrop of the UK property sector. DTZ Investors has addressed what it could mean for various stakeholders involved in the management of commercial real-estate and the impact on asset managers.

Businesses, governments and local authorities are all looking to define what 'net zero' carbon will mean for them and how it can be achieved in practice. DTZ Investors has applied the Green Buildings Councils framework definition for 'net zero', which specifically gives clarity on the definition in construction and building operations.

Background

The Intergovernmental Panel on Climate Change (IPCC) announced that in order to reach the goal of the Paris Agreement to limit the global temperature rise to 1.5°C, profound cuts in greenhouse gas emissions from the global economy are required. The enormity of this challenge can only be met by a united and practical response from governments, businesses and civil society.

As a result, in 2019 the UK government announced a target of 'net zero' for UK GHG emissions by 2050.

What is 'net zero' in Buildings?

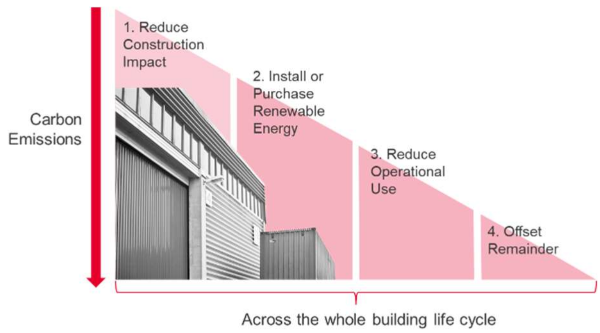
The UK Green Building Council (GBC) has defined 'net zero' in two approaches, 'net zero' in Construction and Operations.

In Construction, 'net zero' is when the associated emissions from the materials, products and construction of getting a building to practical completion are zero or negative through offsets and export of on-site renewables.

In Operation, 'net zero' is when the emissions of the buildings operational energy per annum are zero or negative. Achieved from demonstration of high energy efficiency, and energy from off- or on-site renewable sources, with the remaining balance offset.

See here for the UK GBCs ''net zero' Carbon Buildings'
https://www.ukgbc.org/wp-content/uploads/2019/04/Net-Zero-Carbon-Buildings-A-framework-definition.pdf

Illustration below showing the key components of 'net zero':



As an asset manager DTZ Investors is primarily involved at the operational phase of buildings, accounting for the majority of our assets under management. On this basis we have focused on what 'net zero' means for the stakeholders involved at this point in the building's life cycle.

For 'net zero' in construction DTZ Investors' view is that developers must take a lead role in standardising the approach to embodied carbon and life cycle analysis, with the support from industry bodies, asset managers and property managers. The London Energy Transformation Initiative (LETI) in January 2020 published an informative guide to design in a climate emergency (https://www.leti.london/cedg), in which DTZ Investors is now reviewing and integrating in its own sustainability refurbishment guidelines.

What is the likely effect of 'net zero' on Asset Managers?

Adapting to 'net zero' in the operation of buildings will impact stakeholder groups in different ways. Taking this into account, the following section provides a short summary of what 'net zero' could mean for asset managers.

Investors

Recent years have seen an unprecedented rise in investor concern and action on environmental, social & governance (ESG) issues in real estate portfolios, with demand in transparency and pressure to demonstrate tangible action on the ground. This increase in concern has also included a demand in transparency of the climate-related risks to their investments through frameworks such as the Task Force on Climate-related Financial Disclosures (TCFDs). As we move to an industry recognised framework and implementation model for 'net zero', it is expected the same demand for transparency around 'net zero' will apply.

The difference in 'net zero' though, is that in order to achieve our targets it is recognised that significant investment in building upgrades and infrastructure will be required in the next 20 years. As such, investors are in a unique position to use their influence through the unlocking of capital to invest in these upgrades and also incentivise asset managers to move to 'net zero' through appointment of asset management firms that demonstrate a commitment to 'net zero'.

Occupiers

Increasingly larger corporate occupiers are committing to 'net zero', concentrating initially on their immediate operational impact such as the emissions from the properties they operate from. This is then followed by growing evidence of occupiers' incorporating environmental concerns as part of their workplace strategy, seeking partnerships with asset owners & management firms that will support their ambition and corporate objectives. As occupiers deliver against these promises, collaboration between occupiers and landlords will be observed with focus on how landlords and asset managers operate their buildings efficiently and in line with 'net zero' guidelines.

For occupiers whose sustainability ambitions are less developed, asset management firms will need to revert to Green Lease clauses and occupier engagement to implement 'net zero' assets. Green lease clauses will need to evolve as legislation tightens and 'net zero' pathways are agreed. In addition, clauses which have historically been contended by solicitors and drawn out of leases, including data sharing, and adherence to fit-out guidelines will now carry more weight with the backdrop to net zero and climate change – with the expectation they will be actioned by the occupier and asset manager.

Agents and Valuers

In recent years, there has been an on-going discussion of financially linking green building certifications (BREEAM & LEED) to an increase in asset value and the ability to lease at higher rents. The conclusion to this discussion has been inconclusive with too many other variables. The status quo advice from many agents is that green building certifications will not affect the ability to let in the short term.

However, against the criteria of 'net zero' and climate resilience, asset owners and managers will need to shift thinking to a longer term view in favour of buildings that are future proofed against climate related risk and are performing as 'net zero', decreasing the risk of obsolesce and matching occupier demands for buildings that can demonstrate high resource efficiency, and long term carbon management planning.

Government & Local Authorities:

At a local authority level, many authorities across the UK are working on achieving their own climate targets, some of which are particularly ambitious and ahead of the 2050 deadline. The effect of this for developers and asset managers is stricter local planning regulations and improved demonstration of performance against 'net zero' and reliance on green building certifications.

At a government level, the Department for Business, Energy and Industrial Strategy (BEIS) recently released a consultation on the future trajectory of the Minimum Energy Efficiency Standards (MEES) to 2030. Within the consultation was the government's favoured option of proposing to raise the minimum EPC rating to a band "B" by 2030. The current minimum rating is an E.

As the UK is hosting the United Nation's climate-summit in Glasgow in November 2020, it is expected the government will position itself as a global green leader and therefore legislation under consultation may move to law in 2020. In addition to this, in Spring 2020 the National Infrastructure Strategy is expected to be published with a treasury review on 'net zero'.

This significant shift on energy performance will require a step change to how energy performance is understood and viewed by the industry. The implication for asset owners and managers could be financially significant, if the impact of such changes in legalisation are not evaluated now and not taken into consideration in asset strategy and planning.

Property Managers

Property and Facilities Managers will have a key role in the implementation of operational 'net zero' buildings through their influence in the procurement of third-party contractors and occupier engagement at an asset level.

Property Managers have been historically responsible for many of the procurement functions at an asset level with the management of third-party contractors for plant operation and maintenance, energy procurement, waste management, cleaning and security.

The outcome of 'net zero' for asset management firms is that they will need to take a greater role in the management of the supply chain demonstrating stricter governance, target setting and observation of performance to demonstrate resource efficiency. This is likely to be achieved through evolved Property Management Agreements (PMAs) and Service Level Agreements (SLA).

Summary

From our review, 'net zero' is a welcome opportunity, already galvanising the industry to ensure there is a consistent and credible approach to energy efficiency and GHG reporting in construction and in the operation and management of real estate.

In addition, it poses a significant opportunity for asset owners and managers to react positively and make the necessary changes in asset management practices now to mitigate against obsolescence in future. Those proactive asset owners and managers also have the opportunity now to be at the forefront and be prepared for when 'net zero' and sustainable assets are clearly reflected in the valuation process.

It is clear though that there is still a significant amount of work to do across the industry in order to standardise the approach and behaviour for developers, investors, occupiers, property managers and the supply chain.

For an asset manager with a large diversified real estate portfolio of old and new building stock, the hurdles of retrofitting existing building stocks to achieve higher standards of resource efficiency, engaging FRI tenancies and retrieving energy and carbon emission data from a wide and varied occupier base, currently pose as a challenge and an opportunity.

Asset managers also have a responsibility to ensure assets are not labelled obsolete in the short to medium term, by not being deemed 'net zero' and that focus is still maintained on ensuring assets are resilient from physical and transitional risks associated with climate change.

To conclude, setting a pathway to net zero is an opportunity to grasp now, as such DTZ Investors recognises its responsibility to stakeholders, wider society and the environment to address the challenges and opportunities presented by climate change. DTZ Investors has therefore committed to reducing carbon emissions during developments and refurbishments and developing a pathway to 'net zero' by the end of 2020, with the objective of reducing our operational carbon emissions to zero by 2030.

For additional reading on 'net zero' please follow the links below:

Defining 'net zero' Carbon Buildings' – UK GBC

LETI Design in a climate emergency

Net-Zero the UKs contribution to stopping global warming by the Committee on Climate Change

Net zero carbon: energy performance targets for offices – UK GBC

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