

Climate Change and Responsible Investment Team  
Department for Work and Pensions (DWP)  
Response by email to [pensions.governance@dwp.gov.uk](mailto:pensions.governance@dwp.gov.uk)

6 January 2022

## Climate and investment reporting: setting expectations and empowering savers

### Response to consultation on policy regulations and guidance

We, the Association of Real Estate Funds<sup>1</sup> (AREF), welcome the opportunity to respond to Question 1 in the above consultation. We would like to engage with the DWP, along with the Financial Conduct Authority (FCA), to ensure legislation and regulations include appropriate and aligned climate-related metrics for investments in real estate. Also, there needs to be flexibility to adapt the metrics to ensure they are relevant as climate-related reporting matures.

Please find below a more detailed response to Question 1.

If you would like to discuss our response with us, please contact either myself ([prichards@aref.org.uk](mailto:prichards@aref.org.uk)) or Jacqui Bungay ([jbungay@aref.org.uk](mailto:jbungay@aref.org.uk)), Policy Secretariat at AREF. 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 DWP by sharing this wealth of knowledge and expertise.

Yours sincerely



Paul Richards  
Managing Director, The Association of Real Estate Funds

<sup>1</sup> 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.

## 1.2 Proposals on mandatory portfolio alignment measurement and reporting

**Q1. We propose to amend the Occupational Pension Schemes (Climate Change Governance and Reporting) Regulations 2021 to require trustees of schemes in scope to measure and report their scheme's Paris-alignment by adding a requirement for them to select and calculate a portfolio alignment metric and to report on that metric in their TCFD report.**

### Do you agree with this policy proposal?

AREF supports the requirement for trustees of schemes in scope to measure and report their scheme's Paris-alignment by adding a requirement for them to select and calculate a portfolio alignment metric and to report on that metric in their TCFD report.

The challenge for schemes for investments in real estate as an asset class is selecting an appropriate metric. The FCA helpfully recognises this challenge in FCA PS21/24 *"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."*

It is important that there is an alignment with the FCA rules for TCFD based reporting by asset managers as indicated in FCA PS21/24, to ensure that schemes are able to use the information provided by asset managers. In their responses to consultation CP 21/17<sup>2</sup>, AREF and other real estate industry trade bodies provided the FCA a supporting paper suggesting a possible approach to metrics. This is in the annex to this response, as we believe that it is also an appropriate approach for pension funds.

Now the FCA have published PS 21/24<sup>3</sup>, AREF is meeting with the FCA and DWP in mid-January 2022 to address specific issues for real estate industry as an asset class. We welcome the FCA statements in FCA21/24 that the FCA have *"worked with DWP to ensure broad consistency in the development of our respective TCFD-aligned rules. [The FCA continues] to work with DWP, BEIS and other policy makers internationally to support the flow of consistent information along the investment chain."*

Separate initiatives, including the launch of the long-term asset fund (LTAF), are underway to encourage investment by DC pension schemes in illiquid assets. It is important that the information reported by funds is consistent with the requirements of schemes for their own reporting, and that the reporting across funds is consistent so that schemes can aggregate the reports from different funds in calculating their own reporting metrics. It is important also that the requirements of DC pension schemes are taken into account in the proposals set out in FCA discussion paper DP21/4 on Sustainability Disclosure Requirements (SDR) and product labels. Some DC schemes invest in real estate through funds that are eligible investments for retail investors, so it is crucial that such funds are able to provide the information that DC schemes need to meet their obligations.

We note the publication by The Pensions Regulator on 16 December 2021 of guidance for trustees of occupational pension schemes, *Governance and reporting of climate-related risks and opportunities*<sup>4</sup>. We hope that this guidance will be consistent and appropriately updated to reflect any changes that arise from this DWP consultation.

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<sup>2</sup> FCA Consultation Paper: Enhancing climate-related disclosures by asset managers, life insurers, and FCA-regulated pension providers

<sup>3</sup> FCA Policy Statement: Enhancing climate-related disclosures by asset managers, life insurers, and FCA-regulated pension providers

<sup>4</sup> <https://www.thepensionsregulator.gov.uk/en/document-library/consultations/climate-change-guidance/guidance>

## Annex

### 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

	<b>TCFD (see page 43 of the TCFD Final Report)</b>	<b>SFDR (please see annex I of the draft RTS)</b>
<b>Weighted average carbon intensity (WACI)</b>	<p>Portfolio's exposure to carbon-intensive companies, expressed in tons CO<sub>2</sub>e / \$M revenue. Metric recommended by the Task Force.</p> $\sum_n \left( \frac{\text{current value of investment}_i \times \text{issuer's Scope 1 and Scope 2 GHG emissions}_i}{\text{current portfolio value}} \times \frac{\text{issuer's } \$M \text{ revenue}_i}{\text{issuer's } \$M \text{ revenue}_i} \right)$	$\sum_n \left( \frac{\text{current value of investment}_i}{\text{current value of all investments (€M)}} \times \frac{\text{investee company's Scope 1, 2 and 3 carbon emissions}_i}{\text{investee company's €M revenue}_i} \right)$
<b>Total carbon emissions</b>	<p>The absolute greenhouse gas emissions associated with a portfolio, expressed in tons CO<sub>2</sub>e.</p> $\sum_n \left( \frac{\text{current value of investment}_i}{\text{issuer's market capitalization}_i} \times \text{issuer's Scope 1 and Scope 2 GHG emissions}_i \right)$	$\sum_n \left( \frac{\text{current value of investment}_i}{\text{investee company's enterprise value}_i} \times \text{investee company's Scope 1, 2 and 3 carbon emissions}_i \right)$
<b>Carbon footprint</b>	<p><i>Description</i> Total carbon emissions for a portfolio normalized by the market value of the portfolio, expressed in tons CO<sub>2</sub>e / \$M invested.</p> <p><i>Formula</i></p> $\sum_n \left( \frac{\text{current value of investment}_i \times \text{issuer's Scope 1 and Scope 2 GHG emissions}_i}{\text{current portfolio value} (\$M)} \right)$	$\sum_n \left( \frac{\text{current value of investment}_i}{\text{investee company's enterprise value}_i} \times \text{investee company's Scope 1, 2 and 3 carbon emissions}_i \right)$ <p style="text-align: center;">current value of all investments (€M)</p>
<b>Scope 1, 2 and 3 GHG emissions, disclosed separately</b>	<p>Scope 1 refers to all direct GHG emissions.</p> <p>Scope 2 refers to indirect GHG emissions from consumption of purchased electricity, heat, or steam.</p> <p>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).</p>	<p>The scope 1, 2 and 3 definitions are contained in the low carbon benchmark regulation:</p> <ul style="list-style-type: none"> <li>(i) Scope 1 carbon emissions, namely emissions generated from sources that are controlled by the company that issues the underlying assets; and</li> <li>(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.</li> <li>(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.</li> </ul>

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 Boundary<sup>5</sup> 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.

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<sup>5</sup> 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/m<sup>2</sup> 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/m<sup>2</sup> (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.