SDR and labels policy
Financial Conduct Authority
12 Endeavour Square
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Response by email to cp22-20@fca.org.uk

Response to FCA CP22/20 Sustainability Disclosure Requirements (SDR) and investment labels

We, the Association of Real Estate Funds[1] (AREF), welcome the opportunity to respond to the above consultation.

We support the FCA's principles approach to sustainability disclosures; we feel this principle-focused approach is more appropriate than the prescriptive approach being considered by regulators in other jurisdictions.

Real Estate Associations' SDR Working Group's Guidance Response to FCA CP22/20 (Guidance Response)

AREF members were active participants in drafting the guidance response to FCA CP22/20 by the real estate associations of AREF, BPF, CREFC Europe, INREV and IPF. We have added the guidance response as Annex 1 to this response from AREF. We have made a few updates to the response which we are shown highlighted in yellow within Annex 1.

Submission: Proposals - ESG Metrics for Real Estate 13 January 2023

As mentioned in the Executive Summary to the Guidance Response, in response to a request from the FCA for input on the development of real estate-specific metrics, a submission was made on 13th April 2022. In light of CP22/20, the proposals have been updated as at 13 January 2023[2]; we have included the updated submission as Annex 2 to this response.

Regulatory challenges to implementing Sustainable Investment Labels

We believe that meshing sustainable requirements with current regulations will be challenging. The current investment rules require a breadth in investment which will make it hard for some funds to meet the requirements for sustainable investment labels. Authorised funds for retail investors investing in illiquid assets are finding it difficult to attract new investors due to the uncertainty caused by the FCA not confirming whether notice periods for redemptions will be introduced for these funds. We believe that this is a particular challenge in the context of the SDR proposals as product labelling is likely to be particularly relevant for retail investors. Existing funds have not been set up with explicit ESG investment objectives and it is, in practice, impossible to set up new funds for retail investors to invest in illiquid assets.

We have heard from members that they are spending a lot of time and resources getting to grips with SFDR and other mandatory regulations. For the time being they will possibly not have the bandwidth to ensure their funds are meeting the requirements for a sustainable investment label.

Example real estate fund

In Annex 3 to this response, we have supported the responses to Q6 and Q22 in the Guidance Response with an example of a real estate fund that would not qualify for a sustainability label but is categorised as Article 8 under SFDR. Also, we believe that the proposed marketing prohibitions would be damaging for this fund and would be counter-productive for the objective of encouraging sustainable investment practices.

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[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 £64 billion under management on behalf of their investors. The Association is committed to promoting transparency in performance measurement and fund reporting through the AREF Code of Practice, the MSCI/AREF UK Quarterly Property Funds Index and the AREF Property Fund Vision Handbook.
[2] https://www.aref.org.uk/resource/esg-metrics-for-real-estate.html

Whilst we have pointed out some of the difficulties that we believe the current proposals could raise for the real estate sector and for the objectives of the SDR labelling system, we very much support the initiative and look forward to working further with the FCA on refining it.

Please contact either myself (prichards@aref.org.uk) or Jacqui Bungay (jbungay@aref.org.uk), Policy Secretariat at AREF, to discuss any aspect of our response. Our members invest in real estate and other real assets, in the UK and in other jurisdictions; they are always willing to assist the FCA by sharing their wealth of knowledge and expertise.

Yours sincerely

Paul Richards

Managing Director, The Association of Real Estate Funds

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Annex 1: Real Estate Associations' SDR Working Group's Guidance Response to FCA CP22/20

General comments for Executive Summary

1, In the past decade, the sustainability challenges of the real estate industry have increasingly been in the spotlight. According to the World Economic Forum, buildings account for nearly 40% of global greenhouse gas emissions, 50% of the world's energy consumption and 40% of raw material use. The UK's Department for Business, Energy & Industrial Strategy (BEIS) states[3] that one of the most difficult decarbonisation challenges the nation faces is the built environment and that commercial (including industrial) buildings pose a particular challenge as they account for a third of UK emissions from the built environment.

The buildings use very different amounts of energy, usually dependent on the size of the building. In England and Wales, only 7% of the buildings are larger than 1,000sqm; however, they consume over 53% of all the energy used by commercial buildings and are responsible for the associated carbon emitted from these buildings. Forecasts indicate that approximately 80% of all UK buildings in 2050 have already been built, so a major task is retrofitting existing buildings and determining how to measure and report these decarbonisation efforts."

2, We understand – and support - the consumer protection focus of the Consultation Paper, as well as the FCA reinforcing the following principles:

- anti-greenwashing;
- the "fair, clear and not misleading" promotion condition;
- naming and marketing rules; and
- distribution rules.

3, We welcome the FCA:

- requesting detailed disclosures, targeted at a wider audience (e.g. institutional investors or retail investors) related to:

  > *"Ongoing sustainability-related performance information including key sustainability- related performance indicators and metrics, in a sustainability product report*" [FCA SDR CP paragraphs 1.22 and 3.2]

- indicating that its proposals are a starting point and which will be developed over time – given the FCA proposes:

  > "*to add more specificity to both product-and entity-level disclosure requirements as the ISSB develops its sustainability disclosure standards*". [FCA SDR CP paragraph 5.2]

In response to a request from the FCA for input on the development of real estate-specific metrics, we were pleased to have made a submission now updated as at 13 January 2023 (See Annex 2)[4]

The aim of the submission is to provide consistent, transparent, and comparable reporting and disclosure both across the UK, as well as internationally, for real estate portfolios, covering all real estate asset classes. We proposed that the reporting and disclosure should be aligned with TCFD guidelines and the UK Sustainability Disclosure Requirements.

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[3] https://assets.publishing.service.gov.uk/government/uploads/system/uploads/attachment_data/file/970519/performance-based-policy-framework-ci-buildings--strategy-paper.pdf

[4] https://www.aref.org.uk/resource/esg-metrics-for-real-estate.html

As indicated in that submission, policy - alongside technological advances and industry ambitions for ESG performance – is evolving, ESG metrics for real estate will need to be updated, and we suggest that accordingly the FCA regulations from time to time should be revised to reflect the updates.

We append to this response (in Annex 2) the submission reflecting current technological advances and industry ambitions for ESG performance (including more details on social metrics). We look forward to progressing the dialogue with the FCA to consider market implementation of metrics of this nature – subject to the FCA:

- undertaking its own consultation process; and
- further updating the ESG metrics for real estate as and when appropriate, again subject to the FCA undertaking its own consultation process.

International coherence *(4.64 – 4.67 & Annex 1:1. – 6.)*

We welcome the FCA looking to map its proposed labels to disclosure requirements within the EU SFDR. However, there are concerns in the market with this mapping approach: for instance, there are a number of SFDR Article 8 products which will not meet the criteria to qualify for a SDR sustainable label (particularly since the proposal for a "Responsible" label has been dropped). It is important that these products are still able to accurately disclose their sustainability characteristics, despite not qualifying for a label.

Although the requirements do not directly map across, we welcome a number of improvements in the SDR (e.g. the recognition of transitioning investments as qualifying for a label).

Chapter 3 – Overview, scope and timings

Q1: ***Do you agree with the proposed scope of firms, products and distributors under our regime. If not, what alternative scope would you prefer, and why?***

We agree with the proposed scope of firms, products and distributors under the regime.

We would ask for clarity on whether the reporting at the entity level should be for the in-scope firms, as detailed in Table 1. Where these firms are part of larger UK and global organisations would the entity-level reporting be expected to be at the firm or parent company level? Given that entity-level reporting will build on the TCFD entity report, will this be the same corporate entity as is providing TCFD entity reporting?

We have concerns that it is proposed that overseas funds would not be in scope for the regime initially. This has two principal effects: (i) overseas funds do not benefit from the proposed product labels; and (ii) overseas funds are not subject to the restrictive naming and marketing rules. This could potentially create inconsistency in the market and on this basis, we would suggest that overseas funds marketed in the UK are brought into the regime at the same time as UK funds.

We note that the definition of a TCFD product includes closed-ended funds that make additional investments after 22 July 2013 regardless of whether the funds are open to new investors or not. We appreciate that this definition has been brought across from UK AIFMD but we feel that it requires adapting to say that in the case of SDR, TCFD products include closed-ended funds open to new investors after 30 June 2024 (assuming this date is when SDR comes into effective). Where closed-ended funds are closed to new investors and are no longer being marketed from 30 June 2024 they should be excluded from the scope of SDR altogether; including the naming rules, pre-contractual disclosures and ongoing reporting. It would be of little benefit to investors in these funds to receive updated marketing documents, which may require time-consuming and costly investor consents and regulatory approvals. Also, if these funds are required to change their name to remove any ESG-related terms in order to comply with SDR this could be confusing to their investors. In many cases, closed-ended funds will have also completed their investment period, or will have invested substantial amounts of their capital already, and will not be in a position to negotiate further ESG information rights from portfolio companies post-investment.

Q2: ***Do you agree with the proposed implementation timeline?***
If not, what alternative timeline would you prefer, and why?

We agree with the proposed implementation timeline.

Q3: ***Do you agree with the proposed cost-benefit analysis set out in Annex 2?***
If not, we welcome feedback in relation to the one-off and ongoing costs you expect to incur and the potential benefits you envisage.

In the context that firms are already complying with costs associated with disclosure requirements within the EU SFDR, we are concerned with the additional cost burden arising from the SDR regulatory framework.

Chapter 4 – Classification and labelling

Q4: Do you agree with our characterisation of what constitutes a sustainable investment, and our description of the channels by which positive sustainability outcomes may be pursued?
If not, what alternatives do you suggest and why?

We agree that a key attribute of a sustainable investment product is an explicit environmental and/or social objective and this sustainability objective should sit alongside the financial return objective. Also, this objective should be expressed in specific and measurable terms.

Section 4.7 of the consultation paper states that the outcomes that any investment can achieve for the environment and/or society will reflect both the enterprise contribution and investor's contribution. Enterprise contribution is not appropriate for investment in real assets; real asset funds contribute directly to the sustainability outcomes of the assets they hold.

Box 3 of the consultation paper describes the various direct and indirect channels or mechanisms by which a firm may contribute to a positive sustainability outcome. We have suggested below how these could work for real asset funds.

Active investor stewardship and engagement

Real estate investors could influence the environmental and social performance of their assets through active engagement and through participation in system-wide initiatives rather than by exercising voting or other rights or through shareholder activism. We would be grateful for clarification of the meaning of "system-wide initiatives".

The UK Stewardship Code says the following in relation to real estate and infrastructure:

> *The investment market has changed significantly since the publication of the first UK Stewardship Code. There has been significant growth in investment in assets other than listed equity, such as fixed income bonds, real estate and infrastructure. These investments have different terms, investment periods, rights and responsibilities and signatories will need to consider how to exercise stewardship effectively in these circumstances*

Some of the principles in the UK Stewardship Code are not written with real estate funds in mind. For those principles, we propose that the real estate associations work together and, with the Investment Association (IA) and FRC, produce standards and examples appropriate for investing in real assets. This would consider the whole life cycle of the assets and the intervention of the asset managers at the acquisition, operational and disposal stages. This would include how the asset managers engage with occupiers; how they invest in making physical changes to their assets and the operational management of the assets.

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Influencing asset prices and the cost of capital

As mentioned in section 4.12 of the consultation paper, the asset pricing/cost of capital mechanism may be stronger in less-liquid segments of the market. Asset managers of real estate funds could influence asset prices and the cost of capital by 'screening in' assets that have strong sustainability credentials, and 'screening out' those that do not.

Seeking a positive sustainability impact by allocating capital to underserved markets or addressing market failures

If aligned with their objectives, real assets funds could direct capital to projects and activities that offer solutions to environmental or social problems with the explicit aim of achieving a positive, measurable sustainability impact.

***Q5**: Do you agree with the proposed approach to the labelling and classification of sustainable investment products, in particular the emphasis on intentionality?*
If not, what alternatives do you suggest and why?

We support the introduction of a classification and labelling regime to help consumers (i.e. retail investors) navigate the market for sustainable investment products.

Section 2.14 of the consultation paper states that "intentionality" means "the investor's deliberate intention to achieve the product's stated objective". We note that there is currently no definition of intentionality in the Guidance and we request the FCA to consider whether they should be offering guidance on this point.

Using the definition for intentionality in section 2.14, we would like clarity on whether "stated objective" means that funds will have to update their current objectives to include sustainable objectives for a fund to qualify for a sustainable label. This would not be an easy process; potentially requiring regulatory and investor approval. This could lead to only new funds using the labels.

Investor demand for a sustainable investment label may mean that fund managers feel it is worth the effort to change their funds' objectives. Also, some funds, focussing on, for example. impact investment, may feel that is important that they obtain a sustainability investment label. However, there may not always be investor demand for a sustainable investor label. For example, funds with US investors will need to strike a balance between the desire for a sustainable label and the requirements of certain US investors, who might be restricted from investing in products with sustainability objectives listed alongside financial objectives. Also, institutional investors are more likely to undertake their own analysis of a fund's ESG credentials and are less likely to be concerned about whether a fund has a sustainability investment label or not.

We are pleased that the FCA have stated that there is no hierarchy between the proposed labels. It is important that this is made clear to investors. We would not want investors to believe that one label is better than another. We do note, however, that in the absence of a clear distinction between the three labels, there is a risk of a hierarchy being created where managers choose certain labels over others.

Q6: Do you agree with the proposed distinguishing features, and likely product profiles and strategies, for each category?
If not, what alternatives do you suggest and why? In particular, we welcome your views on:

When AREF presented to DLAG they provided them with examples of real estate funds that would meet the proposed labels in DP21/4. We would have liked the product profiles for each of the labels proposed in the consultation to include an example of a real asset fund that would meet each label. We have liaised with members of our associations and would be happy to provide some examples if helpful.

a. ***Sustainable Focus**: whether at least 70% of a 'sustainable focus' product's assets must meet a credible standard of environmental and/or social sustainability, or align with a specified environmental and/or social sustainability theme?*

b. ***Sustainable Improvers*: the extent to which investor stewardship should be a key feature; and whether you consider the distinction between Sustainable Improvers and Sustainable Impact to be sufficiently clear?**

As mentioned in our response to Q4, we would recommend updates to the UK Stewardship Code to ensure it is appropriate for real asset funds. This would provide real asset funds with standards to enable them to meet the requirements of this label.

We note that, for example, a number of real asset funds that meet Article 8 of SFDR will not qualify for this label due to the intentionality requirement even if, for example, they have a 5-star rating from GRESB and/or a net zero pathway objective. This could lead to confusion and questions from investors. (We have given an example of a real estate fund in Annex 3 which is categorised as Article 8 under SFDR but wouldn't meet the requirements for a label.)

The type of real asset funds that we believe should be able to meet the criteria for the "Sustainable Improvers" label include ones that look to improve existing assets rather than build new.

c. ***Sustainable Impact*: whether 'impact' is the right term for this category or whether should we consider others such as 'solutions'; and the extent to which financial additionality should be a key feature?**

Many of the most impactful real asset funds will be those that look to improve existing assets rather than build new. For example, transitioning stranded buildings is a main component in achieving net zero goals, should funds doing this be labelled as "impact" or "improver" funds?

Where there is potential overlap of this nature, this leads to a risk of creating a hierarchy of labels, as fund managers have the ability to choose their labels. On this basis, we would recommend more clarity and differentiation between the labels.

We acknowledge that the proposals within the consultation paper have been developed primarily in the interests of retail investors. We can understand the reasoning that funds that may meet the requirements of more than one label and are aimed at retail investors should set a clear objective and choose the label most appropriate for the fund. This would make it much easier for retail investors to comprehend the sustainability objective of a fund and compare funds. However, where funds are designed to meet the needs of more sophisticated institutional investors, we feel it would be more appropriate for those funds to be able to use more than one label where appropriate. We would like to engage further with the FCA on this before the final rules are published.

Section 4.42 of the consultation paper mentions the Long-Term Asset Fund which provides a UK authorised open-ended fund structure that enables investment in long-term, illiquid assets. We would also draw the FCA's attention to the Professional Investor Fund (PIF) – to be formalised as unauthorised co-ownership AIF. We very much welcome the 7th December 2022 amendments to the Financial Services and Markets Bill with the effect that the PIF or unauthorised co-ownership AIF will be recognised within the Financial Services and Markets Act[5]: This would be a UK fund structure that enables investment in long-term, illiquid assets and supports investment in sustainability solutions. It will benefit from being efficient to operate, particularly for SME managers; and offering a speed to delivery solution that is important when launching vehicles that can support investment in sustainability solutions.

Q7: Do you agree with our proposal to only introduce labels for sustainable investment products (i.e., to not require a label for 'non-sustainable' investment products)?
If not, what alternative do you suggest and why?

We agree with the proposal to only introduce labels for sustainable investment products.

[5] https://publications.parliament.uk/pa/bills/cbill/58-03/0181/amend/finserv_pro_rep_1207.pdf - NC20 on page 6.

Q8: Do you agree with our proposed qualifying criteria?
If not, what alternatives do you suggest and why? In your response, please consider:

- ***whether the criteria strike the right balance between principles and prescription***
- ***the different components to the criteria (including the implementing guidance in Appendix 2)***
- ***whether they sufficiently delineate the different label categories, and;***
- ***whether terms such as 'assets' are understood in this context?***

We agree that there should be a high bar for the labels but we wonder if this has been set too high. There will be a lot of funds that won't be able to obtain the labels (including certain Article 8 SFDR products, which may have to change the objectives of the fund to qualify for a label). These products will nevertheless be subject to restrictive naming and marketing rules under the SDR proposals.

We recognise, and welcome, the consumer-focus with the FCA's proposed qualifying criteria and welcome the opportunity to develop from the SDR base appropriate criteria applicable for real estate products for institutional investors.

Under the general criteria for applying labels in the draft Handbook text, ESG 3.2.3. (3) (a) states that:

> *(3) A firm must:*
>
> *(a) have in place key performance indicators (KPIs) for the purposes of measuring a sustainability product's ongoing performance towards achieving its sustainability objective, which are:*
>
> *(i) credible, rigorous and evidence based;*
>
> *(ii) relevant to, and aligned with, the sustainability product's sustainability objective;*

As mentioned above, the real estate associations[6] produced a submission dated 13 January 2023 on ESG metrics for real estate which was provided to the FCA, along with TCFD and ISSB. The principles and real estate specific metrics within the paper aim to facilitate consistency of disclosures across the EU and UK as well as internationally where the TCFD's recommendations will apply. While the principles are aimed at supporting consistent reporting and disclosure by international asset managers, local supplements may be appropriate or needed for domestic real estate-specific metrics. In the context of realising this aim, the Working Group has an ongoing dialogue with the FCA.

Q9: Do you agree with the category-specific criteria for:

- ***The 'Sustainable focus' category, including the 70% threshold?***
- ***The 'Sustainable improvers' category? Is the role of the firm in promoting positive change appropriately reflected in the criteria?***
- ***The 'Sustainable impact' category, including expectations around the measurement of the product's environmental or social impact?***

Please consider whether there any other important aspects that we should consider adding

We have no further comments at this stage.

Q10: Does our approach to firm requirements around categorisation and displaying labels, including not requiring independent verification at this stage, seem appropriate*?*
If not, what alternative do you suggest and why?

[6] AREF, BPF, CREFC Europe, INREV, IPF, Pensions for Purpose and The Good Economy

We would ask what enforcement mechanism the FCA plans to put in place for a firm that uses the incorrect label or does not meet some of the requirements for a label they are using.

We note that the FCA is not introducing mandatory requirements for firms to seek independent verification of their labelling at this stage. Although we note that the FCA, in the consultation, encourage firms to seek independent verification. We anticipate that as audit firms are auditing periodic disclosures for SFDR, they may do the same for SDR.

We expect that there will be demand from investors for firms to use the sustainable labels for their funds. As well as ensuring the funds have the appropriate sustainable objectives (see our response to Q5), firms will require additional compliance resources to ensure the proposed criteria have been met in full and the appropriate disclosures are made.

Chapter 5 - Disclosures

Q11: Do you agree with our proposed approach to disclosures, including the tiered structure and the division of information to be disclosed in the consumer-facing and detailed disclosures as set out in Figure 7?

While we agree in general with the proposed approach to disclosures, we note that it can present some sector-specific challenges to implement for real estate.

Q12: Do you agree with our proposal to build from our TCFD-aligned disclosure rules in the first instance, evolving the disclosure requirements over time in line with the development of future ISSB standards?

We agree with the proposal.

Q13: Do you agree with our proposals for consumer-facing disclosures, including location, scope, content and frequency of disclosure and updates? If not, what alternatives do you suggest and why?

We agree with the proposals and, in particular, are encouraged by the fact that sustainability disclosures can and should be made even for investments that are not able to use one of the proposed labels.

Q14: Do you agree with the proposal that we should not mandate use of a template at this stage, but that industry may develop one if useful? If not, what alternative do you suggest and why?

We agree with the proposal and would welcome the opportunity to help develop a template or further guidance specific to the real estate sector.

Q15: Do you agree with our proposals for pre-contractual disclosures? If not, what alternatives do you suggest and why. Please comment specifically on the scope, format, location, content and frequency of disclosure and updates.

We agree with the proposals and, in particular, as we noted in our response to Q13, are encouraged by the fact that sustainability disclosures can and should be made even for investments that are not able to use one of the proposed labels, but where sustainability-related features are integral for a firm's investment policy and strategy.

We would note that, as we mentioned in response to Q1, closed-ended funds no longer being marketed from 30 June 2024 should be excluded from these pre-contractual disclosure requirements.

Q16: Do you agree with our proposals for ongoing sustainability-related performance disclosures in the sustainability product report? If not, what alternative do you suggest and why? In your response, please comment on our proposed scope, location, format, content and frequency of disclosure updates.

We agree with the proposals and support the accountability and transparency obligation that they imply.

As mentioned in our response to Q1, we do not agree with requiring ongoing sustainability related performance disclosures for closed-ended funds that are closed to new investors and suggest the rules be amended accordingly.

Investors in such funds have already negotiated and agreed the terms of such funds, including in relation to ongoing sustainability reporting.

Q17: Do you agree with our proposals for an 'on demand' regime, including the types of products that would be subject to this regime? If not, what alternative do you suggest and why?

We agree with the proposals although in this, as well as in other proposals we would encourage the FCA to explicitly provide for an opportunity to cure any breaches after notice of potential non-compliance before further enforcement action is taken.

Q18: Do you agree with our proposals for sustainability entity report disclosures? If not, what alternatives do you suggest and why? In your response, please comment on our proposed scope, location, format, content, frequency of disclosures and updates.

We agree with the proposals although we believe further clarity should be provided regarding, for example, whether the 'entity' referred to is a UK company or a global group (and whether it is the same entity as is providing TCFD entity reporting).

Q19: Do you agree with how our proposals reflect the ISSB's standards, including referencing UK-adopted IFRS S1 in our Handbook Guidance once finalised? If not, please explain why?

We agree with the proposals although we believe further clarity regarding the scope of potential application of the SASB standards for real estate information would be helpful.

Chapter 6 - Naming and marketing

Q20: Do you agree with our proposed general 'anti-greenwashing' rule? If not, what alternative do you suggest and why?

We agree with the proposals although in this, as well as in other proposals we would encourage the FCA to explicitly provide for an opportunity to cure any breaches after notice of potential non-compliance before further enforcement action is taken.

We also note that challenges can arise in implementing standards to areas where specific local definitions necessarily apply, e.g., what income thresholds are used to determine what constitutes 'affordable' housing?

It would be very helpful if the FCA were to create a mechanism by which guidance could be sought in cases of uncertain application and any guidance given communicated publicly, for example through the quarterly FCA bulletin.

Q21: Do you agree with our proposed product naming rule and prohibited terms we have identified? If not, what alternative do you suggest and why?

We agree with the proposed product naming rule and prohibited terms for product labels.

We would note that whilst this is manageable and achievable for new products, we have concerns about how existing products that potentially include prohibited terms will comply. We would suggest a period of conformance to enable compliance.

Q22: Do you agree with the proposed marketing rule? If not, what alternative do you suggest and why?

We do not agree with the restriction on the use of the prohibited terms within marketing.

We note that paragraph 6.15 of the consultation paper allows for use of these terms where factually describing sustainability-related investment policies and strategies that are integral to a firm's investment policy and strategy. It is not clear, however, how this interacts with the general prohibition on these terms in marketing (as set out in paragraph 6.12 of the consultation paper) – for example, when certain statements are contained in a marketing document, such as a PPM. Additionally, these terms are also materially important to the performance of the fund and therefore are fundamentally required to be integrated into any consumer-facing documentation.

Examples of common uses of these terms that are essential to be able to include in marketing to provide a factual view of an ESG integrated investment strategy:

- If the manager is a signatory to PRI and score
- If the manager is a signatory to Net Zero Asset Managers Initiative
- Manager's own net zero carbon pathway or responsible investment strategy, often aligned to the UN SDGs
- GRESB (Global Real Estate Sustainability Benchmark) rating for the product
- Green building certifications case studies and statistics. BREEAM, Net Zero Carbon Building Standard, NABERS, LEED,
- kWhr of renewable energy generated (renewable is not listed as a prohibited term, but the list provided is not exhaustive

As such, we would propose that the use of these terms should be prescribed/limited to factual description of actions and a disclaimer should be used to clarify that the inclusion of this information does not imply or import a sustainable product label. In the case of existing funds, we would like to discuss with you further the implications of compliance with these requirements and appropriate scope for grandfathering reliefs.

We believe that prohibiting these terms would have unintended consequences:

- Funds may no longer be able to describe the investment and governance actions they are taking as part of an ESG integrated investment strategy. The FCA cites these actions as being increasingly expected and a required standard. Accordingly, this would have the result of undermining the expected approach from the FCA, disadvantaging those non-labelled products and arguably undermining the wider ESG agenda, as there is less incentive for these managers to focus on ESG integration as they are unable to disclose this to their investors.
- Products which have already ensured that they are SFDR-compliant by accurately disclosing their sustainability characteristics may not be able to use this prospectus language to market in the UK. This could result in UK investors receiving less information than EU investors, for example, leaving them less informed when making an investment decision.
- Application to solely retail investors could lead to a significant mismatch between disclosures provided to professional investors and those provided to retail investors, potentially resulting in retail investors receiving less information on the ESG characteristics of the products that they invest in.

In addition, there is a need to ensure consistency between these requirements and those which currently apply to fund products (including other UK regulations).

We have set out in Annex 3 an example of a fund for which the proposed marketing prohibitions would be damaging and would be counter-productive for the objective of encouraging sustainable investment practices.

Q23: Are there additional approaches to marketing not covered by our proposals that could lead to greenwashing if unaddressed?

We are concerned about the mismatch between UK retail products and overseas retail products (particularly ones outside of SFDR) that would be created by this proposed approach. Such mismatch could then be compounded with the delay in the launch of complementary rules covering overseas funds which are marketed in the UK. As a result, UK retail funds could be at a significant disadvantage when marketing a product in the UK which does not meet the criteria for an SDR label and is subject to the restriction on the use of the prohibited terms in the product name or marketing materials. Such restrictions would not apply to overseas funds, which could create a distorted market.

The other issue that we have concerns about is the unofficial application of consumer facing disclosures in retail products into institutional products. We understand that the FCA will be consulting separately on institutional products, but we would suggest that from a harmonisation and implementation perspective, such rules should come in to force near-simultaneously to avoid market-implied application.

Chapter 7 - Distributors

Q24: Do you agree with our proposals for distributors? If not, what alternatives do you suggest and why?

We agree that where products have a sustainable investment label, distributors must display the label prominently on the relevant digital medium and provide access to the accompanying consumer-facing disclosures.

We also agree that where prohibited sustainability-related terms are used in relation to the naming and marketing of overseas products that are recognised schemes, distributors must place a notice on that product, alerting retail investors that: "This product is based overseas and is not subject to FCA sustainable investment labelling and disclosure requirements". We also support the proposal that the notice be accompanied by a hyperlink to the FCA webpage which will set out what the labelling and disclosure requirements are for retail investors that wish to know more.

As per our responses to Q23 above, we would propose that, the permanent approach for overseas products is expedited (where possible) to avoid creating a two tier system.

Chapter 8 – Next steps

Q25: What are your views on how labels should be applied to pension products?
What would be an appropriate threshold for the overarching product to qualify for a label and why?
How should we treat changes in the composition of the product over time?

We agree that labels should be applied to pension products and we would expect the rules to be consistent with the application of the labels for funds and portfolio management.

We appreciate the challenges with the fact that investment profiles change as the consumer moves nearer to retirement. However, we would expect the constituents of a consumer's pension should be meeting the sustainability requirements in the rules even if the type of underlying funds being invested in may change overtime.

Q26: Do you consider the proposed naming and marketing rules set out in Chapter 6 to be appropriate for pension products (subject to a potentially lower threshold of constituent funds qualifying for a label)?
If not, why?
What would be an appropriate threshold for the naming and marketing exemption to apply?

We do consider the proposed naming and marketing rules set out in Chapter 6 to be appropriate for pension products, subject to the responses we have given to Q20-Q23.

Q27: Are there challenges or practical considerations that we should take into account in developing a coherent regime for pension products, irrespective of whether they are offered by providers subject to our rules or DWP's requirements?

We have no comments on the challenges or practical considerations the FCA should take into account in developing a coherent regime for pension products, irrespective of whether they are offered by providers subject to FCA rules or DWP's requirements. However, we do agree that the FCA should consider the interaction between labels and disclosures by firms in scope of FCA rules and disclosures by firms in scope of DWP requirements.

Q28: To what extent would the disclosures outlined in Chapter 5 be appropriate for pension providers ie do you foresee any challenges or concerns in making consumer-facing disclosures, pre-contractual disclosures and building from the TCFD product and entity-level reports?

We agree with reducing the burden for providers by not requiring them to provide sustainability disclosures in more places than they would already be required to. As our members are not pension providers, we are unable to provide any comments on challenges for pension providers in making the disclosures required in Chapter 5.

Q29: Do you agree that the approach under our TCFD-aligned product-level disclosure rules should not apply to products qualifying for a sustainable investment label and accompanying disclosures? Would it be appropriate to introduce this approach for disclosure of a baseline of sustainability-related metrics for all products in time?

We have no comments on whether the provisions relating specifically to the calculation of product-level metrics would be necessary in respect of products qualifying for a sustainable investment label and the accompanying disclosures. Neither do we have any views on whether it would be appropriate to introduce these provisions when expanding the regime to introduce a baseline of sustainability-related metrics that firms would be required to disclose for all products, irrespective of whether or not they have a label.

Q30: What other considerations or practical challenges should we take into account when expanding the labelling and disclosures regime to pension products?

As our members are not pension providers, we are unable to provide any other considerations or practical challenges that should be taken into account when expanding the labelling and disclosures regime to pension products.

Q31: Would the proposals set out in Chapters 4-7 of this CP be appropriate for other investment products marketed to retail investors such as IBIPs and ETPs. In your response, please include the type of product, challenges with the proposals, and suggest an alternative approach.

We have no further comments at this stage.

Annex 2

SUBMISSION: PROPOSALS – ESG METRICS FOR REAL ESTATE

13 January 2022

TO:

UK Financial Conduct Authority (**FCA**)
Taskforce on Climate-related Financial Disclosures (**TCFD**) and
International Sustainability Standards Board (**ISSB**)

FROM:

Association of Real Estate Funds (**AREF**)
British Property Federation (**BPF**)
Commercial Real Estate Finance Council Europe (**CREFC Europe**)
European Association for Investors in Non-Listed Real Estate (**INREV**)
Investment Property Forum (**IPF**)
Pensions for Purpose (**PfP**) and The Good Economy (**TGE**)

(together, **the Associations**)

INTRODUCTION

The Associations welcome the FCA continuing to take a leading role on environmental, social and governance (**ESG**) regulatory issues. For instance, under FCA regulations, large UK pension funds and fund managers must comply with the TCFD guidelines across all asset classes. The FCA is now proposing a package of measures including sustainable investment labels, disclosure requirements and restrictions on the use of sustainability-related terms in product naming and marketing, under the Sustainability Disclosure Requirements (**SDR**)[7],

In parallel with the FCA's proposed SDR, the European Commission plans compliance with the disclosure requirements on principal adverse impacts (**PAIs**) under the EU's Sustainable Finance Disclosure

[7] Financial Conduct Authority (FCA) 25 October 2022. CP22/20: Sustainability Disclosure Requirements (SDR) and investment labels: https://www.fca.org.uk/publications/consultation-papers/cp22-20-sustainability-disclosure-requirements-sdr-investment-labels

Regulation (**SFDR**) by 30 June 2023[8,9,10,11]. The FCA has signalled that it has considered the SFDR in its proposals for enhanced climate-related disclosures and plans an ESG sourcebook[12] relating to ESG compliance. The FCA also notes in the SDR proposals that it has sought, as far as possible, to achieve international coherence with other disclosure regimes notably the SFDR in the European Union (EU) and proposals by the Securities and Exchange Commission (SEC) in the United States (US).

While the SDR propose that sustainable investment labels are mandatory for UK investment funds marketed to retail investors, detailed disclosure requirements will impact institutional investors and at this stage the FCA proposes not to mandate the use of a template but signals industry may develop one if useful. The Associations recognise that the TCFD has a climate-finance focus, whereas the SFDR and the SDR have a broader ESG remit, and there is a need for appropriate real estate metrics that support robust, transparent and comparable disclosure for investors to understand both climate and holistic ESG performance.

The proposals contained in this document represent the views of a working group (**Working Group**) of the Associations in response to a dialogue with – and request from – the FCA for the real estate industry sectors' views/ suggestions/ input, principally aimed at a set of best practice principles in support of consistent reporting and disclosure transparency:

- to inform the development of real estate-specific metrics that enable consistent, transparent, and comparable reporting and disclosure for real estate portfolios and covering all real estate asset classes (committed via equity and/or debt); and
- that are aligned with TCFD guidelines (and intended to supplement the PRI - Technical Guide: TCFD for real asset investors) and the evolving SDR, where the Working Group understands no industry template for real estate is proposed.

These principles and real estate specific metrics aim to facilitate consistency of disclosures across the EU and UK as well as internationally where the TCFD's recommendations will apply. While the principles are aimed at supporting consistent reporting and disclosure by international asset managers, local supplements may be appropriate or needed for domestic real estate-specific metrics. In the context of realising this aim, the Working Group looks forward to progressing the dialogue with the FCA and

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8 Official Journal of the European Union. 27 November 2019. Regulation (EU) 2019/2088 of the European Parliament and of the Council of 27 November 2019 on sustainability-related disclosures in the financial services sector (Text with EEA relevance): https://eur-lex.europa.eu/legal-content/EN/TXT/?uri=celex%3A32019R2088

9 ESMA. JC 2021 03. 2 February 2021. Final Report on draft Regulatory Technical Standards with regard to the content, methodologies and presentation of disclosures pursuant to Article 2a(3), Article 4(6) and (7), Article 8(3), Article 9(5), Article 10(2) and Article 11(4) of Regulation (EU) 2019/2088: https://www.esma.europa.eu/sites/default/files/library/jc_2021_03_joint_esas_final_report_on_rts_under_sfdr.pdf

10 ESMA. JC 2021 50. 22 October 2021. Final Report on draft Regulatory Technical Standards with regard to the content and presentation of disclosures pursuant to Article 8(4), 9(6) and 11(5) of Regulation (EU) 2019/2088: https://www.esma.europa.eu/sites/default/files/library/jc_2021_50_-_final_report_on_taxonomy-related_product_disclosure_rts.pdf

11 European Commission. 25 November 2021. Information regarding regulatory technical standards under the Sustainable Finance Disclosure Regulation 2019/2088: https://www.esma.europa.eu/sites/default/files/library/com_letter_to_ep_and_council_sfdr_rts-j.berrigan.pdf

12 FCA Enhancing climate-related disclosures by asset managers, life insurers, and FCA-regulated pension providers. CP21/17.

resolving a time frame for appropriate implementation, recognising that some metrics are implementable sooner than other metrics.

For clarification, the position of debt investors in real estate differs from that of equity investors in real estate (for example, in terms of access to data, or which emissions fall within which scopes), as do those of different types of debt investor (consider for example, a fund that lends directly to real estate firms in the same way that a bank might, compared to a fund that invests in senior rated bonds issued by listed property firms or securitisation vehicles). The Working Group understands that (i) these proposals also have the support in principle of associations representing debt investors, and (ii) those associations would look to engage with the FCA to consider whether additional proposals would be appropriate to address the position of debt investors in real estate. At this stage, it has not been possible to develop specific recommendations for how SDR should affect real estate lenders and debt investors.

The principles have been shared across a range of real estate industry associations and so reflect cross-industry sector collaboration and input. The principles seek to progress end-to-end solutions to the question of appropriate real estate specific metrics. The Working Group has focused on material issues applicable for real estate portfolios and the underlying assets, rather than at the entity level and, therefore, entity level governance and oversight disclosure requirements are not covered in this document. For proposals at product level disclosure, the Working Group suggests considering relevant guidelines produced by industry bodies, such as the INREV Governance and Sustainability Guidelines[13].

These principles and suggested metrics have considered issues that are broadly applicable across all real estate asset classes such as climate resilience, mitigation and adaptation, energy and energy efficiency, carbon, water, waste, the circular economy, biodiversity, and social value. However, the Working Group acknowledges that individual real estate portfolios and developments may have specific material risks and opportunities not addressed within these proposals and suggests such risks and opportunities should be subject to further disclosure obligations. It is also acknowledged that this is not an exhaustive list of ESG metrics for real estate disclosures. Additionally, it should be noted that the ability to report against these metrics will vary depending on the type of asset class (residential, industrial, office, retail, leisure and specialist asset types such as datacentres), development type (new construction versus retrofit) and.as mentioned above. debt versus equity real estate funds. Organisations will not be able to report on all of these metrics from day one nor are these proposed as a set of criteria for the three sustainable investment labels under the SDR. Therefore, the Working Group puts forward these principles and suggested metrics on the basis that they are not mandatory but voluntary metrics that provide investment and asset managers, and other industry stakeholders with freely available, material and comparable real estate specific metrics that support consistent and transparent disclosure.

As policy - alongside technological advances and industry ambitions for ESG performance – evolves, ESG metrics for real estate will need to be updated, and (as appropriate) the FCA regulations from time to time revised to reflect the updates.

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[13] INREV. January 2023. Professional Standards: Governance: https://www.inrev.org/guidelines/module/governance#inrev-guidelines Sustainability: https://www.inrev.org/guidelines/module/sustainability-2023#inrev-guidelines .

PRINCIPLES

Reporting principles are required to standardise the approach to reporting across a variety of parties. They should include:

1. **Transparency**: Relevant stakeholders should be transparent in their approach to reporting and supply complete disclosure of all activities within the stated scope and boundary, the granularity of data reporting, and avoid reporting only on positive results. For context, disclosure should be accompanied by information on the limits of the environmental and/or social resources at the sector, local, regional, or global level.
2. **Consistency and comparability**: All parties are encouraged to disclose a minimum set of ESG metrics for real estate applying standardised reporting methodologies, scope and reporting boundaries to support comparability across the market. Comparability needs to be between investment types and between real estate asset classes. It is envisaged that the minimum set of ESG disclosure metrics for real estate would be supplemented with other metrics, as appropriate, for investment portfolios and the different real estate asset classes.
3. **Verification**: All parties are encouraged to verify data to an external standard using independent third party verification. Nevertheless, the Working Group acknowledges the practical challenges for landlords associated with the verification of occupier data.
4. **Detailed data notes: All parties must disclose emissions factors, estimation methodology,** scope and boundaries, and any limitations, such as use of benchmark/proxy data in the absence of actual portfolio/asset specific data. Details on any acquisitions, divestment, and/or policy changes and how they affect portfolio performance and trends over the reporting period shall be included[14].
5. **Simplicity**: Some reporting metrics involve complex calculations. The aim should be to keep ESG metrics for real estate and data collection as simple as possible to ensure reporting is cost effective, feasible to collect and achieves optimal coverage.
6. **Measurement over modelling**: Actual data is preferred over modelled or benchmark/proxy/estimated data. If it is not possible to collect and measure actual data, reasons for using alternative data and the methodology used must be disclosed and justified. This presents practical challenges in a landlord and occupier scenario. Legislative changes will be required to achieve this goal if this cannot be achieved by voluntary action.

The Working Group requests that these reporting principles will dovetail with standards to be adopted by the International Sustainability Standards Board (**ISSB**)[15]. As noted above, this is not an exhaustive list and that the ability to report these metrics varies depending on the type of asset class (residential, industrial, office, retail, leisure, datacentre, etc.), development type (new construction versus retrofit) and debt

[14] TCFD. Proposed Guidance on Climate-related Metrics, Targets and Transition Plans (October 2021).
[15] https://www.ifrs.org/content/dam/ifrs/project/climate-related-disclosures/industry/issb-exposure-draft-2022-2-b36-real-estate.pdf

versus equity real estate funds. The Working Group has provided some indicative ESG metrics for real estate disclosures in the Appendix for consideration by the FCA and industry stakeholders.

LESSONS LEARNED FROM THE EU SFDR AND TAXONOMY

It is widely recognised that there are differences in the calculation methodologies between the TCFD's recommendations and the SFDR, as well as inconsistencies with energy performance certificate (**EPC**) ratings in the UK and among EU member states.

For example, for carbon and GHG reporting, real estate adopts the Operational Control Boundary as described under the GHG Protocol, which includes whole buildings into the footprint rather than the amount of equity invested. This is standard practice for INREV and European Public Real Estate Association (**EPRA**) reporting, as well as the definition of reporting under Global Real Estate Sustainability Benchmark (**GRESB**) and is particularly complicated for residential buildings. This should include tenant emissions from the building and will be an applicable reporting, although this is optional under GRESB. Note under the updated INREV Sustainability Reporting Guidelines[16], tenant controlled energy consumption and renewable energy generated/purchased by tenants have become required disclosure KPIs, applicable after the transition period. The Working Group recognises the practical challenges of obtaining occupier data but as outlined in Principle 4 **Detailed data notes**, parties should disclose and justify data gaps clarifying the proportion of floor area for which actual, proxy and/or no data is provided.

Therefore, regardless of whether emissions fall into Scope 1, 2 or 3, the Working Group advocates whole building emissions are disclosed, and tenant emissions should be included where feasible and appropriate.

WEIGHTED AVERAGE CARBON INTENSITY (WACI)

The Working Group recognises that the TCFD WACI metrics are not universally applied for real estate where revenue/rents are not considered within reporting; also if rents are variable. However, end investors often ask for the TCFD WACI metrics to be reported and many asset managers have adopted this as a disclosure metric and consider it useful as an indicator of investment risks. In addition to facilitating firm-wide reporting, real estate teams may need to calculate WACI using rental income as a denominator for TCFD reporting.

The Working Group also experiences end investors requesting footprint intensity vs Assets Under Management. If real estate uses just the TCFD WACI metric this may not sufficiently describe ESG risks. It should also be noted that the WACI metric does not align with the metrics employed for building regulation compliance, which is a key transitional risk driving change.

As such the Working Group recommends that besides allowing parties to apply the WACI metric, real estate metrics for carbon intensity normalised by floor area should also be presented, as this gives a more accurate picture of change for most asset classes than normalising by value[17]. The Working Group

[16] The updated INREV sustainability reporting guidelines became available on INREV website in January 2023.
[17] As alternative normalisation metric to floor area, number of units can be added for asset types where floor areas are not routinely measured and recorded: for example, with residential sector.

reiterates the importance of disclosing whole building data, including occupier data, and clarifying data gaps, to ensure data normalised by floor area accurately reflects intensity.

The Working Group suggests that investors should be able to compare real estate performance with that of other investment asset classes, but there should also be a consensus that enables real estate reporting metrics between different types of real estate investments.

CARBON FOOTPRINT

The floor area is typically used as a denominator when measuring the carbon footprint of a real estate asset and the Working Group recommends that ESG metrics for real estate continue to be normalised by floor area (see footnote 17). However, to enable aggregation or comparison with other investment sectors, carbon footprint intensity for real estate may also need to be measured by investment value for TCFD reporting.

ENERGY PERFORMANCE CERTIFICATES AND OPERATIONAL/IN-USE ENERGY RATINGS

In the UK, EPCs are a theoretical measure of intended performance and have been subject to criticism on the accuracy of benchmarking actual in-use performance of buildings. The diversity of EPC categorisation across member states in the EU also creates disclosure challenges for pan-European investors. While there are some current efforts underway to modernise EPCs, which are to be welcomed, the Working Group advocates the reporting and disclosure of actual operational performance using operational energy intensity metrics and ratings that benchmark against the typical practice, and test whether a building aligns with climate-related and net-zero carbon targets. This recommendation aligns with the proposals by BEIS for the introduction of a performance-based policy framework applicable to large commercial and industrial buildings[18].

In countries where regulation of EPC ratings in both the commercial and residential rented sectors has a trajectory to improve ratings by 2030, this has proved a significant financial motivator for energy efficiency improvements within the wider real estate industry. Many organisations have integrated EPC improvements into their Transition Plans and monitor EPC ratings as a climate-related metric. Coupled with operational energy ratings that drive building management and use improvements, we believe that EPCs have a role to play in real estate energy efficiency and should remain as part of a wider group of ESG performance metrics for real estate.

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[18] BEIS. March 2021. Consultation: Introducing a performance-based policy framework in large commercial and industrial buildings: https://www.gov.uk/government/consultations/introducing-a-performance-based-policy-framework-in-large-commercial-and-industrial-buildings

PRIMARY ENERGY DEMAND AND ENERGY USE INTENSITY

Primary Energy Demand (**PED**) is a metric identified for real estate under the EU Taxonomy (**EUT**) for Sustainable Activities and PAI of the SFDR[19]. Primary Energy metrics will be available for new construction and refurbished projects for both commercial and residential real estate in the UK and Europe.

However, many real estate sector organisations consider PED to be a complex metric to calculate. An additional, reporting real estate metric is Energy Use Intensity (**EUI**) (measured as kWh/m2/year (Gross Internal Area **GIA**, **or** Gross Floor Area **GFA or** Net Lettable Area **NLA**[20])) that is more closely related to building energy use and efficiency.

The Working Group recommends the application of the EUI metric alongside the PED.

REPORTING CHALLENGES

As noted above, data coverage, particularly occupier data collection, and quality are key challenges for the real estate sector. It is not always possible to collect the data required as there is no statutory requirement for residential or commercial occupiers to provide energy and other utility data to the property owners. Although contractually in the terms of the leases under which the asset is held or by virtue of a Memorandum of Understanding, many occupiers will be required to share such data, this is generally only in newer leases (i.e. "green" leases) or occupational arrangements. There are significant data protection complexities for institutional residential landlords and operators in collecting energy data even where they can arrange access with the utility company and/or tenants/occupiers. This problem is going to be exacerbated with GHG Scope 3 requirements when data on indirect emissions will need to be collected such as tenant demise, embodied carbon across the life cycle and arguably associated transport emissions.

While technological advances and data management platforms are improving, and there is increasing landlord and occupier collaboration and data sharing, plus increasing application of "green" leases in the commercial sector, there are still considerable data gaps. Ultimately, it is very difficult for a landlord to evict an occupier for not sharing their energy data, despite what may be in the lease. Similarly, even when full reporting is possible in a residential context, there are limits to how much influence landlords can exert over tenants regarding energy use and intensity in their own homes vs the common areas. The ongoing energy crisis presents additional pressures in terms of fuel poverty risks and unfortunately the most energy efficient solutions are still usually the most expensive. The granularity of operational residential real estate is a particular challenge but the institutional and social housing sectors are investing heavily in community engagement programmes as well as retrofitting and new technologies.

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[19] The EUT also makes reference to a Nearly Zero-Emission Building (NZEB) as part of the criteria for real estate assets. The EU has also proposed to move from the current nearly zero-energy buildings to zero-emission buildings (ZEB) by 2030. For a definition of a NZEB and a ZEB, and more information on EU proposals refer to: https://energy.ec.europa.eu/topics/energy-efficiency/energy-efficient-buildings/nearly-zero-energy-buildings_en#:~:text=Nearly%20zero%2Demission%20building%20(NZEB,produced%20on%2Dsite%20or%20nearby

[20] The Working Group acknowledges there may be challenges when applying GIA, and data may be presented using NLA. GRESB also applies to Gross Floor Area (GFA): GRESB - Real Estate Reference Guide. Appendix 3a - Property Types Classification. Stakeholders should clearly state the floor area metric applied.

In line with Principle 6, actual data is preferred over modelled or benchmark/proxy data. This presents practical challenges in a landlord-tenant and occupier scenario and raises policy issues on appropriate voluntary or mandatory disclosures. Legislative changes will be required to achieve this goal.

ESG BEYOND THE 'E'

Decarbonising the real estate sector is critical, particularly in order to achieve the UK government's legislated target to achieve net zero by 2050. A vast majority of the real estate metrics, benchmarks and analysis focuses on carbon, GHG and energy use reporting but it is important to acknowledge that a huge amount of work and activity is underway across the sector beyond the 'E' of ESG. We would encourage the FCA to address all aspects of ESG across real estate beyond the "E".

In relation the 'S' in ESG, we refer to the Appendix to this Submission pages 19 to 23 inclusive.

Good governance is obviously a vital component of all responsible and effective organisations that represent the Associations' varied membership but through an ESG lens many are undertaking specific additional governance measures, in particular to advance D,E&I (Diversity, Equality and Inclusion) across the industry.

CONCLUSION

The Working Group welcomes further engagement with the FCA, TCFD Secretariat, ISSB to expand upon and discuss the contents of our proposals.

They are grateful for the opportunity to be involved at this stage of policy development to deliver a workable outcome for the real estate sector.

WORKING GROUP

Many have contributed to our Working Group in drafting and settling these proposals. These proposals would not have been possible without their support. We would like to acknowledge the support from key members:

- Alex Notay – PFP Capital: Chair, BPF ESG/Residential Working Group, AREF ESG & Impact Investing Committee Member
- Bahar Yay Celik – INREV
- Georgie Nelson – abrdn: Head of ESG, Real Estate: AREF ESG & Impact Investing Committee Member
- Helen Newman – CBRE: CIBSE Knowledge Panel Member, CREFC ESG Working Group Member, ULI UK Sustainability Product Council Vice Chair
- Julie Townsend – PGIM Real Estate, Director of ESG, Europe & Asia: ULI UK Sustainability Product Council Member
- Lora Brill – Orchard Street: IPF ESG Committee Member
- Melville Rodrigues – Apex Group: AREF Public Policy Committee Member
- Oliver Light - Carbon intelligence: AREF ESG & Impact Investing Committee Member
- Vivienne King – The Good Economy: Head of Real Estate Social Impact

DISCLAIMERS

This document is for information purposes only. The information is believed to be correct, but cannot be guaranteed, and the opinions expressed constitute the views of the Working Group members in a personal capacity as of this date but are subject to change. The views do not necessarily represent the views of their organisations or the Associations

Reliance should not be placed on the information and opinions set out in the document for the purposes of any particular transaction or advice.

The Associations and the Working Group members do not accept liability arising from any use of this document.

APPENDIX

As noted above, the Working Group has focused on material issues applicable for real estate investment portfolios and the underlying assets, rather than at the entity level and therefore, entity level carbon emissions associated with activities such as business travel are not included below. Governance and oversight disclosure requirements are also not covered here.

ENVIRONMENTAL AND SOCIAL REAL ESTATE METRICS

The aim of these principles is to achieve consistency, comparability and a holistic ESG view – applying decision-useful, robust, transparent, quantifiable, measurable, objective, trackable, and verifiable thresholds and criteria applicable to real estate and aligned to TCFD, SDR, SFDR reporting and disclosure requirements on climate and sustainability and evidence suitability.

Greenhouse gas (GHG) Scope 1-3 emissions

The scope 1-3 indicator proposed is aligned with real estate reporting. The existing tools and processes being adopted by real estate firms describe risks clearly and have processes already reporting to them. So, we would recommend aligning the ESG metrics for real estate disclosures with these. In particular:

- Using calculations based on open-source tools such as the Carbon Risk in Real Estate Monitor (**CRREM**) spreadsheet to communicate intensities. It should be clearly stated whether intensities are reported in Gross Internal Area (**GIA)**, or Gross Floor Area (**GFA**) or Net Lettable Area (**NIA**)[20].
- In a context of assessing potential values at risk due to poor carbon performance, it is proposed that asset level comparisons be based on location-based emissions.
- Maintaining the operational control boundary and making clear the different boundaries within reporting if equities and real estate are reported in a unified way.

Operational GHG reporting should include Scope 3 (in terms of tenant-controlled energy consumption) and sum to the Total Operational Carbon Emissions. Without Scope 3 tenant emissions, the footprint is not an accurate assessment of risk.

Real estate investment portfolios should be developing Scope 3 reporting of whole life carbon (WLC) emissions, including embodied and operational carbon. Several metrics that may be appropriate in light of relevant circumstances, include:

- Purchased goods and services – typically undertaken by mechanical and engineering and property management services (good practice is to undertake a life cycle assessment (**LCA**) on the product, process, or service);
- New construction, major refurbishment, and fit-out work – through an WLC assessment and aligned with industry benchmarks;
- Tenant energy consumption – most tenant consumption data is still estimated by landlords, despite green lease arrangements requiring tenants to share consumption information and the availability of smart data acquisition solutions in the market, it is frequently difficult to obtain actual tenant energy data. A regulatory requirement for tenants to authorise utilities to share

consumption data with landlords would significantly aid the disclosure of carbon real estate risks to investors;

- Water, waste, and refrigerant (fugitive emissions) related emissions and associated emissions factors (including Scope 1 – Landlord; and Scope 3 – tenant emissions) – calculated from a combination of utility consumption data and benchmark modelling regarding GHG emissions:
  - Report portfolio absolute Scope 1, 2 and 3 emissions (tonne kg CO2-e/yr) and carbon intensity (tonne CO2-e/sqm/yr)
  - Align with an accepted framework (such as the GHG Protocol and the UK Green Building Council (**UKGBC**)) on Scope 3 reporting in commercial real estate (several metrics that may be relevant to Scope 3 emissions include Whole Life Carbon and embodied carbon, waste, water, and refrigerants (fugitive emissions) etc).

Whole Life Carbon – Operational and Embodied Carbon

As noted above, embodied carbon of real estate falls under Scope 3. Evaluation and reporting of whole life cycle impacts of real estate, including upfront embodied, operational, and end of life impacts should be the norm across the real estate sector. The Technical Expert Group (TEG) advising on the EU Taxonomy also signal that embodied carbon will be integrated into the taxonomy criteria with a threshold defined by the mid-2020s[21].

The Working Group encourages that new construction and major refurbishment projects within a fund/portfolio report the 'upfront' embodied carbon (Stages A1-A5 Cradle to Practical Completion) in line with the RICS Professional Statement 'Whole life carbon assessment for the built environment and International Construction Measurement Standards V2, and BS EN 15978:2011.

Embodied carbon reporting associated with the property maintenance, landlord and Cat B tenant fit-outs, and deconstruction works is not currently standard practice but should be a goal for ESG metric for real estate disclosure in the medium-term (2025 or later).

Whole Life Carbon metrics

Evaluation and reporting of whole life cycle impacts of real estate, including upfront embodied, operational, and end of life impacts are encouraged as follows:

- Report the % of developments/major refurbishment projects and the area (e.g. sqm or sq ft) that have undertaken a Whole Life Carbon assessment in line with the RICS Professional Statement 'Whole life carbon assessment for the built environment and International Construction Measurement Standards V2, and BS EN 15978:2011.
- Report the % of developments/major refurbishment projects and the area (e.g. sqm or sq ft) with embodied carbon being estimated using benchmarks such as CIBSE.

[21] RICS. April 2020. News & Opinion: RICS explains next steps on EU Taxonomy & low carbon Buildings: https://www.rics.org/de/news-insight/latest-news/news-opinion/rics-experts-talk-on-eu-taxonomy--low-carbon-buildings/

- For the proportion of assets in a portfolio with calculated embodied carbon, report the 'upfront' embodied carbon (Stages A1-A5 Cradle to Practical Completion) in $kgCO_2e/m^2$ (GIA/NLA) [20] and aligned with industry benchmarks.

Energy

The Working Group recommends that ESG metrics for real estate for energy be normalised by floor area as this gives a more accurate picture of change than normalising by value. Organisations may also choose to normalise by value in order to support their stakeholders in aggregating reporting across multiple investment types. They also recommend including a submetric of "percentage that is estimated" for energy metrics. This is in line with multiple existing sustainability reporting standards' approach to energy and carbon including INREV, GRESB and the Carbon Emissions Template produced by the Association of British Insurers, the Investment Association, and the Pensions and Lifetime Savings Association. Taking into account the Better Building Partnership's Climate Commitment guidance and the UK Green Building Council's net zero carbon hierarchy, they recommend that the primary energy metrics should be for whole building operational energy consumption (occupier and landlord) to drive improvements in energy efficiency and that this should be reported for all assets under management.

The Working Group recommends the use of the following primary metrics for energy for real estate disclosures:

ENVIRONMENTAL PRIMARY METRICS RECOMMENDED FOR ANNUAL DISCLOSURE

Primary metrics are all voluntary but highly recommended for industry stakeholders to adopt. These are aligned to the required KPIs under INREV Sustainability Reporting Guidelines[22] and support the net zero carbon hierarchy goal for buildings to reduce energy demand, maximise on-site renewables and renewable energy procurement.

Environmental factor	INREV aligned indicator ID	Indicator	Units of Measure
Energy consumption[1]	ENV1	Energy consumption, for the proportion of portfolio that is in landlord's control	kWh
	ENV2	Energy consumption, for the proportion of portfolio that is in tenant's control	kWh
	ENV3[2]	Estimated energy consumption (separate disclosure for the proportion of portfolio that is in landlord's and tenant's control)	kWh
	ENV4	Total energy consumption (ENV1 + ENV2 + ENV3)	kWh
	ENV5	Total energy consumption data coverage, by area[3]	% of m2
	ENV6	Energy intensity (based on ENV4) (SFDR Annex 1 Table 2 Additional Real Estate PAI – 19) [3]	kWh / m2
	ENV7	Energy intensity (based on ENV4), by property type[3]	kWh / m2
Renewable Energy[6]	ENV8	Generated and consumed on-site by landlord (SFDR Annex 1 Table 1 Universal PAI - 5)	kWh
	ENV9	Generated on-site and exported by landlord (SFDR Annex 1 Table 1 Universal PAI - 5)	kWh
	ENV10	Generated and consumed on-site by third party or tenant (SFDR Annex 1 Table 1 Universal PAI - 5)	kWh
	ENV11	Generated off-site and purchased by landlord (SFDR Annex 1 Table 1 Universal PAI - 5)	kWh
	ENV12	Generated off-site and purchased by tenant (SFDR Annex 1	kWh

[22] The INREV Sustainability reporting guidelines include a list of required and recommended KPIs that are categorised as: 1) data and disclosures which are required to be included in a vehicle's annual report to comply with INREV guidelines and 2) a recommended dataset comprising a more comprehensive list of metrics which provide a more granular view of a vehicle's ESG performance across a wide range of aspects. The updated guidelines became available on INREV website in January 2023.

Environmental factor	INREV aligned indicator ID	Indicator	Units of Measure
		Table 1 Universal PAI - 5)	
	ENV13	Renewable energy data coverage, by area[3]	% of m2
Greenhouse Gas Emissions (GHG)[7]	ENV14[2]	Direct emissions – Scope 1 (SFDR Annex 1 Table 2 Additional Real Estate PAI – 18)	tonne CO2e
	ENV15[2]	Indirect emissions – Scope 2 (SFDR Annex 1 Table 2 Additional Real Estate PAI – 18)	tonne CO2e
	ENV16[2]	Indirect emissions – Scope 3[4] (SFDR Annex 1 Table 2 Additional Real Estate PAI)	tonne CO2e
	ENV17[2]	Estimated emissions, by scope 1, 2, 3	tonne CO2e
	ENV18	Total operational carbon (SFDR Annex 1 Table 2 Additional Real Estate PAI - 18)[8]	tonne CO2e
	ENV19	Total operational carbon data coverage, by area[3 & 8]	% of m2
	ENV20	Operational carbon intensity (based on ENV18) (SFDR Annex 1 Table 1 Universal PAI - 3) [3]	tonne CO2e / m2
	ENV21	Operational carbon intensity (based on ENV18), by property type[3]	tonne CO2e / m2
Climate Change – Transition Risks and Opportunities	ENV22	Exposure to fossil fuels through real estate assets (SFDR Annex 1 Table 1 Real Estate PAI – 17)	% of AUM
Climate Change – Physical Risks and Opportunities	ENV23	Proportion of assets that fall into low / medium / high physical risk categories accompanied by explanation of methodology applied and definitions of risk categories[9]	% of AUM
Water Consumption	ENV24	Water consumption, for the proportion of portfolio that is in landlord's control	m3

Environmental factor	INREV aligned indicator ID	Indicator	Units of Measure
Waste Management	ENV25	Waste generated, for the proportion of portfolio that is in landlord's control	tonne
Building Certificates	ENV26	Percentage of assets with a certificate[5], by area[3]	% of m2
Energy Ratings	ENV27	Percentage of assets with an energy rating[5], by area[3]	% of m2
	ENV28	Exposure to energy-inefficient real estate assets (SFDR Annex 1 Table 1 Real Estate PAI 18)	% of AUM

Notes:

1. Energy consumption figures include total of different energy types used, including the renewable energy sources).

2. Explain the methodology used to calculate this indicator and/or to determine the components used.

3. Recommended unit of measure for data coverage is by area; investment managers may identify and report an additional KPIs on value (AUM basis).

4. Scope 3 emissions in the INREV sustainability reporting guidelines are calculated as the emissions associated with tenant areas, unless they are already reported as Scope 1 or Scope 2 emissions. Scope 3 emissions do not include embodied carbon as it is listed separately as a recommended KPI under Appendix 1. Scope 3 emissions cover only operational activities of the portfolio of the vehicle and do not include emissions generated through the organisation's operations or by its employees, or upstream supply chain emissions.

5. For the full list of certificates/energy rating schemes refer to GRESB Real Estate Reference Guide.

6. There are a variety of views on what constitutes renewable energy procurement. It is suggested that portfolios report the proportion of landlord controlled renewable energy that is backed by Guarantees of Origins (GoOs) (EU) or Renewable Energy Guarantees of Origin (REGO) (UK), as the minimum standard. It may also be of value to break this down into further detail in terms of sleeved or non-sleeved Power Purchase Agreements, bundled REGOs, etc.

7. To align with TCFD asset managers may present KPIs as a proportion of fund value.

8. Taking a whole building approach and justifying data gaps, and clearly reporting use of estimated/proxy data.

9. Recommended unit of measure for data coverage is by area; investment managers may identify and report an additional KPIs on rental value (AUM basis) to identify risk of non-compliance with proposed MEES legislation in England and Wales, and legislation current (e.g. France) or proposed for EU countries (e.g. EPBD).

SECONDARY METRICS

Secondary metrics should be optional rather than mandatory. Secondary metrics that organisations should consider reporting for real estate support the goals of domestic energy policy that aims to eliminate fossil fuels from heating,. These secondary metrics could include, but are not limited to, the following:

Secondary energy metrics

- **Assets under management that do not use fossil fuels as their main heat supply**, reported as a percentage of floor area (% of floor area). This can be extrapolated from Energy Performance Certificates' "Main heating fuel" field.

Secondary Climate Resilience

Climate resilience is a material risk for real estate. Many of the metrics detailed hereafter align with the TCFD guidance as defined by "[Task Force on Climate-related Financial Disclosures Guidance on Metrics, Targets, and Transition Plans]", published October 2021.

ESG metrics for real estate disclosures to be considered include:

- **Transition risk metrics: Transition Plans:** Transition risk exposure is a material risk and opportunity identifying the potential for real estate assets to adapt in support of a low carbon economy, and a key component of TCFD guidance.
  - **Disclose scenarios and inputs** e.g. parameters, timelines, real estate-specific metrics, and methodologies[23]
  - **Assets under management:**
    - Report both the proportion of underlying assets[24] by area (e.g. sqm or sq ft) (and additionally by value if required) of properties that have **a science-based, 1.5C aligned Transition Plan** undertaken and aligned with TCFD guidance for real estate[25] and the metrics outlined below for physical and transition risks. Transition Plans should address a range of acute and chronic physical risks and have clear mitigation strategies.
      - Tools/resource include (but not limited to): Carbone 4 Climate Risk Impact Screening; 427 Physical Climate Risk Application; GRESB/Munich Real Estate Climate Risk Platform, ClimateWise/CISL Physical Risk Framework; and Swiss RE Climate Risk Score Framework.
    - **Transitional risk analysis:** report % of underlying assets and the area (e.g. sqm or sq ft) of properties that have been analysed using analysis such as CRREM. Separately report the % of underlying assets and the area (e.g. sqm or sq ft) of properties that are

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[23] TCFD. Proposed Guidance on Climate-related Metrics, Targets and Transition Plans (October 2021)
[24] 'Underlying assets' refers to all the RE properties/assets held within the reporting portfolio.
[25] Principles for Responsible Investment (PRI). Technical Guide: TCFD For Real Assets Investors. Available from: https://www.unpri.org/download?ac=13337

at risk of stranding, and the proportion and area that have asset level improvement plans/strategies aligned with the 1.5C target.

    - **Acquisition: Organisational policy requirement that physical climate risk and the use of risk assessment models such as CRREM analysis - should be undertaken as part of the due diligence process.**
    - **New construction: new construction should report on its alignment to the World GBC and local equivalent e.g. UKGBC definition of Net Zero targets.**

- **Physical climate risk metrics:** Report both the proportion of underlying assets[26] by area (e.g. sqm or sq ft) (and additionally by value if required) that has a climate adaptation and transition plan with supporting evidence.

Circular Economy

Waste and use of raw materials are material ESG risks, and the EU Taxonomy includes Circular Economy (**CE**) objectives, although the criteria is currently focussed on waste. It should be noted that GRESB currently focuses on operational waste and does not request construction and demolition waste or CE in construction reporting. However, CE objectives should be broader than simply waste metrics, and should include information on the use of sustainable materials and embodied carbon; recycling, reuse, and repurposing of existing materials and components within a retrofit or construction project.

The real estate sector is increasingly developing CE strategies for properties and developments, and leading organisations are developing inventories of a property's construction materials to enable the future proliferation of Buildings As Material Banks (**BAMB**).

The Working Group encourages the consideration of broader CE metrics for real estate to be adopted in portfolio reporting and disclosure for both standing assets and development projects, including retrofit.

Biodiversity

Aligned with INREV reporting guidelines and SFDR (Annex 1 Table 2 Additional Real Estate PAI – 22) report:

- **Land artificialisation** – Share of non-vegetated surface area compared to the total surface area of the plots of all assets.

With work on the Taskforce on Nature-Related Financial Disclosures (**TNFD**) framework, it is appropriate that a holistic goal for ESG disclosure will incorporate biodiversity disclosure metrics for real estate. The FCA should engage with TNFD in due course.

[26] 'Underlying assets' refers to all the RE properties/assets held within the reporting portfolio.

SOCIAL METRICS FOR REAL ESTATE

This guidance is concerned with delivering positive social impact in real estate as a means of responding to the **local needs** of people and place. Any evaluation of social impact or social value should be focused on the metrics which evaluate an organisation's objectives or help drive certain outcomes corresponding to those needs. Social impact metrics necessarily vary depending on portfolio composition, nature of the asset, geographical context and corporate strategy. Whilst the level of intent may vary, the expectation in this guidance is for **intentionality**, **additionality and measurement** to be integrated into impact strategy as defined below.

The goal is for a holistic set of example social impact metrics for real estate which reflect the spectrum of impact objectives and goals/outcomes being adopted by funds and other real estate investors including enterprises.

This guidance sets out the considerations for addressing social impact using the recently published SDR 'labels' in the FCA consultation document as a framework. It is not a mandated interpretation of the SDR, not does it attempt to be an exhaustive list of metrics for all scenarios. The metrics are suggested examples of what a fund or enterprise may consider, pending metrics being detailed within the SDR framework, itself.

Distinguishing between social impact and social value in real estate

<u>Social value</u> refers to buildings, places and infrastructure supporting environmental, economic and social wellbeing, **and in doing so** improving the quality of life of people. [UKGBC adaptation]

<u>Social impact</u> refers to investments made with the **intention** to generate positive, **measurable** social and environmental impact **alongside** a financial return, in response to a local or wider societal **need.** [GIIN adaptation]

Integrating process principles

The expectation in this guidance is for the four principles below to be integrated into strategic design.

<u>Intentionality</u>: Stated intention to have a defined positive social impact through investments, assets and activities. Impacts are defined as part of strategy and investments are assessed against social impact criteria as well as financial return thresholds.

<u>Local needs:</u> Needs analysis should be undertaken based on primary or secondary data including stakeholder engagement, o reveal local needs which the asset/ scheme /purpose/ activity is responding to, with the overall performance aggregated at fund level.

<u>Additionality:</u> The positive impact that would not typically have occurred without the investment. It should be driven by an identified local or broader societal need. <u>Impact measurement and management:</u> The processes used by an organisation to measure impact performance against appropriate metrics and collect data against the metrics and to identify, assess and manage performance.

Scope of this guidance

The metrics in this guidance:

- Relate to all funds not only impact funds and also for these purposes, enterprises, notwithstanding enterprises are not captured by the proposed SDR at present
- Do not claim to represent a definitive proposition. They are examples of metrics which could be considered where a fund or enterprise is seeking to align with the proposed SDR labels, 'sustainable focus' 'sustainable improver' and 'sustainable impact' in order to inform the categorisation, whilst no baseline metrics currently exist under SDR.
- Include both quantitative and qualitative metric suggestions in order for an holistic view of impact to be reflected
- Can be applied or adapted to be either objective driven, i.e. apply to impacts which an organisation can directly control or outcome driven:. impacts which an organisation cannot claim sole responsibility for e.g. because of the counterfactual.

Framework

Adoption of an existing framework is recommended to help structure the evaluation of what can legitimately be expected from the market in achieving positive social impact. A number of existing frameworks are relevant to real estate, e.g. Impact Management Platform, Global Impact Investing Network, United Nations Environment Programme Finance Initiative Positive Impact Real Estate Investment Framework.

For current purposes, we have taken the three Labels proposed by the FCA's SDR Consultation as the adopted structure – 'Sustainable improver' 'Sustainable Focus' and 'Sustainable Impact'. In applying labels or classifications, the SDR also refers to these channels, 'labelling of sustainable investment products should emphasise the actions that the firm takes in the product's investment policy and strategy to contribute to positive outcomes for the environment and/or society. This would include:-

- the value that the firm adds through asset selection, portfolio construction and investor stewardship:
- active investor stewardship and engagement,
- influencing asset prices and the cost of capital,
- seeking a positive sustainability impact by allocating capital to underserved markets or addressing market failure'.

This guidance also suggests channels which may apply to each label.

This guidance assumes minimum legal obligations are already being performed. Minimum legal compliance does not therefore form part of the metrics framework to support assessment of impact creation[27].

[27] See instead the EU Platform on Sustainable Finance's draft report on minimal safeguards in relation to the Taxonomy Regulation Art. 3c./18.

Example legal compliance metrics:

- Minimum wage pertaining to the asset jurisdiction is paid to operational staff (i.e. security, cleaning, catering and maintenance personal) and construction workers.
- Labour standards pertaining to the asset jurisdiction are observed for all onsite employees (including supply chain). (UK labour law or International labour standards)

Social Metrics Framework

<u>Sustainable Improvers.</u> Invests in assets that may not be sustainable now, with an aim to improve their sustainability for people and/or planet over time[28]

Primary channel: Investor stewardship – directed towards encouraging and accelerating improvements in sustainability performance

Secondary channel: Influencing asset prices, through asset selection of products best-placed to improve sustainability performance

Example metrics

- **OBJECTIVE: Affordability** – % site value to be converted to affordable work/ living space for SMEs/low and middle- income households.
- **OBJECTIVE: Placemaking** - % of AUM intended for placemaking which is adjacent to or connected to a scheme which capitalises on local cultural assets and potential to improve mental and physical health and wellbeing.
- **OBJECTIVE: Occupier health & wellbeing -**
    - introducing a systematic process for measuring occupier health and wellbeing with physical and mental health facilities designed into schemes including air quality natural light and noise exposure strategies
    - number of health safety & wellness programmes run for different stakeholders e.g. employees, tenants, customers etc. (per asset) with the aim of improving health and wellbeing standards in the asset over time.

[28] Strict definition: Products with an objective to deliver measurable improvements in the sustainability profile of assets over time. These products are invested in assets that, while not currently environmentally or socially sustainable, are selected for their potential to become more environmentally and/or socially sustainable over time, including in response to the stewardship influence of the firm

Sustainable Focus. Invests mainly in assets that are sustainable for people and/or planet[29]

Primary channel: influencing asset prices (i.e. reducing cost of capital for sustainable activities)

Secondary channel: responsible stewardship to influence improvements in sustainability performance

Example metrics

- **OBJECTIVE: Blended uses** - % portfolio value to affordable housing/specialist care places which are meeting local need in an otherwise mid-market /build to rent/private healthcare portfolio
- **OBJECTIVE: Placemaking** – %of AUM with objectives aimed at targeting local issues by type – improving community health and wellbeing, reducing crime, tackling homelessness, which the market has to date failed to address.
- **OBJECTIVE: Skills development** –Number of skills development opportunities for disadvantaged groups and % undertaking supported ongoing training for over 12 months
- **OBJECTIVE: Thriving economy -** Proportion of additional jobs created through development/AUM where operational staff i.e. security, cleaning, catering and maintenance personal and construction workers are paid at least the London Living Wage / Real Living Wage (jurisdictional equivalent).

Sustainable Impact. Invests in solutions to problems affecting people or the planet to achieve real impact[30]

Primary channel: Allocating capital to underserved markets or to address market failures

Secondary channel: Investor stewardship to influence improvements in sustainability performance

Example metrics

- **OBJECTIVE: Specialist care provision -** Number of specialist care units provided for those earning less than a predefined percentage of local median income, including people on very low to low household incomes, older and/or disabled people.
- **OBJECTIVES: Affordable housing:**
  - Number of affordable homes in underserved locations for those earning less than a predefined percentage of local median income.
  - Number of individuals projected to be housed in underserved locations as a result of affordable housing investments for those earning less than a predefined percentage of local median income.

[29] Strict definition: Products with an objective to maintain a high standard of sustainability in the profile of assets by investing to (i) meet a credible standard of environmental and/or social sustainability; or (ii) align with a specified environmental and/ or social sustainability theme

[30] Strict definition: Products with an explicit objective to achieve a positive, measurable contribution to sustainable outcomes. These are invested in assets that provide solutions to environmental or social problems, often in underserved markets or to address observed market failures

‘Affordability’ is interpreted as a maximum percentage of gross income which may differ from country to country and also depend on whether it is a percentage of net, gross, individual or household income. In the UK, no more than c. 35% of net household income spent on housing costs is considered to be affordable, i.e. a person is not overburdened by their costs relative to their net income.

- **OBJECTIVES: Community cohesion** –% AUM in assets whose primary purpose is by managing social issues by type – reducing crime, tackling homelessness, improving community health and wellbeing which the market has to date failed to address.
- **OBJECTIVES: Skills development** –Creating skills development opportunities for disadvantaged groups and % undertaking supported ongoing training for over 12 months

OBJECTIVE: Dynamic economy – % AUM invested with a primary purpose of creating local jobs paid at least the London Living Wage / Real Living Wage (jurisdictional equivalent) where job opportunities have previously been underserved.

Annex 3: Example – ABC Real Estate Fund

We set out below an example of a fund for which the proposed marketing prohibitions set out in Question 22 would be damaging and would be counter-productive for the objective of encouraging sustainable investment practices.

ABC Real Estate Fund invests in UK sited commercial real estate and real estate assets. The fund's investment strategy focuses on acquiring existing assets with potential for improvement, including reduction of carbon emissions. In its ESG Strategy, the fund has set a target of improving the EPC of its assets to at least a 'B' within five years of acquisition or 2030, whichever is soonest; however, this is not a formal objective of the fund. The fund is not open to retail investors; however as few real estate funds actually are, we are using it as an example here on the assumption that the rules, once in place, will extend to include funds targeting professional and institutional investors only.

ABC has developed an ESG Strategy and set a Net Zero Pathway for the fund. Its investment manager is a signatory to the UN PRI and a Pending B Corporation. It has hired a dedicated Head of ESG and uses 'best-in-class' professional advisors.

ABC markets to investors in the EU and is therefore subject to SFDR. The Fund is categorised as an Article 8 product under SFDR as it promotes climate change mitigation through the reduction of greenhouse gas emissions. It aims to transition assets within the portfolio to net zero GHG emissions by 2050 by reducing their carbon footprint, improving energy efficiency, procuring energy from renewable sources and actively engaging with tenants.

The Fund investment strategy integrates ESG factors in the following ways:

- Pre-acquisition: During the pre-acquisition phase, both financial and ESG drivers of target assets are examined by the investment team to weigh up sustainability risks and opportunities as part of the investment due diligence process. The external professional advisory team has been educated on the fund's ESG Strategy and Net Zero Pathway and provided with a detailed Request for Information (RFI) that specifies the information they are expected to collect. One or more members of the investment team carry out site visits and the asset is added to the fund's green buildings tool. Using this information, the fund's Head of ESG prepares an ESG Asset Improvement Plan, identifying actions against a list of ESG factors, and improvement costs (for example, of works required to meet the fund's minimum EPC 'B' level) are factored into financial modelling. A summary assessment of the ESG factors relevant to an investment and the ESG risk screening is presented to the Investment Committee (IC) before its determination, enabling the IC to properly assess the ESG risk factors before determining whether to recommend an investment.

- Asset Management: All refurbishments are focused, innovative and tailored to occupier requirements by developing scopes of work that will deliver on the KPIs set out in the bespoke business plan. Assets will be monitored throughout the hold period and the ESG Asset Improvement Plan will be updated annually and following any interventions. Stakeholders will be regularly updated with the last executed actions through quarterly investor reporting and regular (at least annual) updates to tenants.

- Disposal: At disposal, the vendor due diligence pack will include a bespoke carbon reduction plan, detailing any works carried out during the hold period, their impact on emissions, an up-to-date CRREM model and a future timeline showing other interventions that could be made to keep the asset on a 1.5°C trajectory. Historical energy consumption data will also be provided.

Although ABC Real Estate Fund does have "an objective to deliver measurable improvements in the sustainability profile of its assets over time" in the form of its commitment to improve the EPC rating of its assets, it could not evidence that its investment strategy is "geared towards identifying those assets that are best-placed to improve their sustainability profile over time" as it does not have any binding requirements for the assets that it buys, for example, only buying assets that are at or below an E. It would therefore be very difficult, if not impossible, for ABC Real Estate Fund to demonstrate “intentionality” on the part of its investors.

Therefore, it is likely that ABC Real Estate Fund would fall into the category described in Section 2.4 of the consultation – “products without a sustainability objective, but which may use strategies such as ‘ESG integration’ would not qualify for a sustainable label”.

ABC Real Estate Fund does not have a sustainable investment objective and is clear in its marketing materials that this is the case. However, the manager has done a considerable amount of work and made significant investment that is aimed at both reducing carbon emissions from their assets and being an overall responsible property owner, and global citizen. ABC’s investors want to know about these things and their concern is that if the rules evolve as they anticipate, then they will not be able to provide this information to potential investors in the UK. They would also face a practical issue in that they will have to place information on their website to satisfy SFDR that would potentially put them in breach of SDR. Although surmountable, it seems evident that the options available to square this circle are going to cause confusion to anyone accessing the company’s website.

ABC Real Estate Fund’s focus on improving existing assets directly contributes to the sustainability challenges highlighted in the Executive Summary of the Real Estate Associations’ Guidance Response (i.e. tackling the significant proportion of the UK’s emissions from the built environment). That in itself is not necessarily enough to qualify for a sustainability label, but it should not be the case that such a fund is essentially prohibited from telling potential investors what it is doing, especially when those efforts are over and above the current market norm. Many of the UK’s commercial real estate assets are already at risk of becoming stranded because the costs of carrying out the retrofitting needed to put them on a net zero trajectory are too high to make a viable business case for many fund managers. Funds like ABC Real Estate Fund occupy a particular market niche where they are targeting these very buildings because they are able to improve their performance and make a return for investors. If they are unable to attract investment, then they will no longer buy these buildings and that will result in real-world consequences that go beyond just carbon emissions. It also means buildings that will become unlettable, creating blight on communities and affecting jobs and local economies.