rating The way to responsible investment

The climate change agenda in the European real estate sector

Vigeo Findings

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According to the **International Energy Agency (IEA)**, buildings account for 30% to 40% of total global final energy demand and over 30% of all energy-related CO2 emissions. However, between 2000 and 2012 global final energy consumption of buildings increased by 1.5% per year, more than twice the 0.7% considered by the IEA as the threshold to limit climate change to a global average rise of 2° by 2025[1]. Vigeo latest review of the **Real Estate sector - concluded in the end of August 2015 and covering 33 listed European real estate companies** - shows some encouraging results in terms of integration of the climate change agenda in the long-term strategy of major sector players:

· 45% of the companies adopted a formal Environmental Policy with clear reduction targets in terms of environmental impact of their buildings. **Foncière des Régions,** for instance, defined an action plan with the objective to reduce primary energy consumption per square meter on average by 25% for its entire portfolio by the end of 2015 against 2008 levels, and by an additional 15% by 2020 against 2015 baselines.

· The sector is slowly but steadily moving towards a more systematic portfolio approach to responsible property investments. 54% of companies disclose comprehensive processes to integrate environmental standards in their investment strategies. For instance, **British Land** set minimum environmental standards for all acquisitions and development of retail (BREEAM Very Good), commercial (BREEAM Excellent) and residential buildings (Sustainable Homes CSH Level 4). In addition, environmental checklists for all property management and development activities are disclosed.

· 20 out of 33 companies provide information on properties with environmental certifications, like BREEAM or HQE, although only 8 of them (24%) have more than 30% of their portfolio green-certified. Good performers include **Unibail-Rodamco** – with the majority of its retail and office portfolio BREEAM in-use certified – and **Gecina** that has 63% of office buildings with HQE certification for operations.

· The energy efficiency of buildings is also the result of landlord-tenants cooperation. Only a third of companies displays robust or advanced performances in this field. Popular measures are the use of green annexes, awareness raising initiatives and sharing of utility data, while more advanced solutions (as mutual environmental tenant-landlord targets and the adoption of dedicated policies) are still rare. A good practice is offered by **Unibail–Rodamco** that in 2014 had 62% of active leases including green lease clauses and 54% of managed shopping centers with tenant-landlord environmental committees.

· The transparency on key performance indicators is overall improving. Almost 40% of companies display energy and carbon intensities of the property portfolio decreasing over the past years. **Hammerson** for instance reduced the like-for-like energy intensity of its UK shopping centers portfolio by more than 20% between 2010 and 2014. At **Klépierre,** the like-for-like carbon intensity per surface area of the portfolio decreased by 14% between 2012 and 2014.

[1] Source: "Energy efficient building envelopes" - IEA - 04/05/2015; "Tracking Clean Energy Progress 2015" - IEA - 2015

Forward

In recent years the final energy consumption of buildings has increased globally more than twice the threshold value to achieve the 2° target. With an awaited return to a sustained global growth and with a fast increasing population, this trend might not invert any time soon if green retrofits of buildings are not significantly scaled up.

Europe has already made important steps to improve the energy efficiency of its buildings, notably with the 2012 Energy Performance of Buildings Directive (EPBD), but more stringent policy measures are ahead. In 2014 with the new **EU 2030 Energy Strategy** EU Member States agreed to cut by 40% the greenhouse gas emissions compared to 1990 levels. On the basis of this framework, in July 2015 France adopted the new **Energy Transition for Green Growth** law aiming to reduce greenhouse gas emissions by 40% by 2030 and by 75% by 2050 compared to 1990. In addition, the UN **COP21 in Paris** next December could finally endorse the 2° target with an international binding agreement.

Beyond the legislative trends, real estate companies can already benefit from a strong **business case for energy efficiency improvements**. Energy efficiency is key in reducing operational costs for both tenants and owners, and "greener" buildings already have higher marketability[2]. Moreover, the sustainability and environmental performance of buildings is increasingly important also within the investor community, also because of its link with the return on investment[3]. As showed by the research of Vigeo, this strong business case does seem to be fostering a culture of transparency and responsibility on environmental and climate change issues within the real estate sector. However, **large gaps are still visible between leaders and followers**: while 45% of the companies demonstrate advanced and improving practices on environmental issues, almost a 30% still shows a weak performance.

In a period of growth and consolidation of the European REIT sector, with stricter environmental legislations ahead, real estate companies will be increasingly expected to fill these gaps and further improve their sustainability with enhanced transparency and innovative solutions. To fully free the huge potential of retrofit opportunities, new dedicated financing channels and instruments are also needed. **Green Bonds** for instance - if based on key material indicators and backed by robust environmental, social and governance strategies - can represent for the real estate sector an alternative way to finance profitable investments that contribute to the transition to a low carbon economy.

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[2] In commercial real estate for instance, the UNEP FI Property Working Group reports that a 30% improvement in building efficiency is estimated to have an internal rate of return (IRR) of 28.6% over a 10-year period. Source: "Commercial Real Estate: unlocking the energy efficiency retrofit investment opportunity" - UNEP FI - February 2014.

[3] For instance, a recent research from the University of Cambridge shows that more sustainable Real Estate Investment Trusts (REITs) are associated with higher operational and stock market performances. Source: Fuerst, Franz, "The Financial Rewards of Sustainability: A Global Performance Study of Real Estate Investment Trusts", 16 June 2015.