# Environmental Sustainability: Q&A Series

## M&R and Fidelity Real Estate - in conversation with Ewan Montgomery, Portfolio Manager, UK Real Estate


Fidelity Real Estate is growing real estate business within Fidelity International, an established investment management house. Fidelity has $2.7bn in real estate assets under management, split between European and UK funds and other third-party mandates. Sustainability plays an integral part in every aspect of the Fidelity investment process, with ESG considerations incorporated throughout the full life cycle of their asset ownership.

In October 2021, Fidelity Real Estate published its Net Zero Carbon Commitment showing how it will approach the transition to net zero carbon. Their commitment has two key phases:

> Phase 1: Fidelity Real Estate Funds will be Net Zero Carbon in terms of Scopes 1 &2 (Landlord controlled) emissions by 2035
> Phase 2: Fidelity Real Estate Funds will be Net Zero Carbon by 2050.

Phase 1 will achieve operational net zero carbon focussing on Scope 1 and 2 emissions by 2035. Phase 2 will deliver material net zero carbon (including Scope 3 emissions) by 2050 or sooner. Fidelity have put in place comprehensive policies and strategies to achieve these goals. They have set 13 clearly defined sustainability targets, against which they can track progress and have created a hierarchy for dealing with greenhouse gas emissions.

Fidelity seeks to actively collaborate with their tenants, using lease events as triggers to incorporate green provisions in leases and insisting on a minimum level of green clauses in new leases. By working together with their tenants to develop action plans, they are seeing results. They have had recent success on several projects, where assets which required modernisation have been substantially transformed to meet Fidelity's exacting sustainable refurbishment requirements. Collaboration with construction teams is also important here so everyone approaches projects with the same mindset and goals from the outset.

Concerns for the RE sector's move towards sustainability include the lack of resources and skills within the wider industry, how to deal with embodied carbon and how to gain greater visibility and control over Scope 3 emissions outside the direct control of the landowner.

Sustainability of its assets is clearly fundamental to Fidelity Real Estate. It has set ambitious targets and put in place comprehensive strategies to achieve these. It is aware of the challenges it will need to overcome on the way. Taking incremental steps and fostering a collaborative approach with its tenants will no doubt help it to meet its goals.

Read on to learn more about the Fidelity's targets, achievements and future plans.

## What carbon reduction targets have you set and how did you set them?

Fidelity have definitely been picking up the pace in terms of how we approach our sustainability targets in past years. We have an internal working group focussing entirely on how our funds get to net zero carbon, with support from external consultants to guide us through the process.

We have a two-phase strategy to get us to net zero carbon for all emissions from buildings where we are the custodians by 2050. This includes tenant emissions. The intermediate step is to achieve net zero carbon for Scope 1 and 2 emissions by 2035. These are the landlord-controlled emissions, such as gas and electricity usage in our assets. Any development or major refurbishment will also have to be net zero from the intermediate date.

We have 13 sustainability targets, relating to energy and carbon; water and waste; social engagement; and certification and reporting. Many are linked to 2023 and are clearly defined to help us track progress. For example, we want to procure 100% electrical energy from renewable sources by 2023 where economically and operationally feasible, reduce our energy consumption by 15%, our Scope 1 and 2 emissions by 25% and our water consumption by 10% by 2023. Good progress is being made towards these targets.

## What strategies have you put in place to achieve your targets?

Our approach is to look to firstly remove emission generation wherever possible (for example by removing the use of gas from properties entirely) then further reduce emissions by using more efficient systems. The next step is then ensuring we use renewable energy (which is generated onsite ideally or through the use of green contracts). Any residual emissions can be difficult to deal with. We do not necessarily want to be in the carbon credit or offset market, but would consider nature-based carbon removal strategies, including purchasing land or partnering with other landowners to generate our own verifiable carbon credits.

We have created a Greenhouse Gas management hierarchy to manage down emissions, which looks to:

1. Eliminate – remove energy requirements from building use where possible;
2. Reduce – by increasing efficiency in operations, processes and energy management and using technology to optimise approaches;
3. Substitute – by adopting on site renewable generation and then procuring decarbonised electricity;
4. Compensate – for unavoidable residual emissions.

## What have been the drivers for setting targets?

It is important for us to be a positive influence in the communities in which we hold assets. As part of our commitments, we are looking to develop a method for formally evaluating our contribution to social value by 2023.

Our investors are predominantly institutions, local authority pension funds and European investors. We're seeing that those investors have picked up the pace and depth of their questioning on sustainability metrics. There is now a real desire to know the detail of the carbon intensity of assets and how funds compare.

Many of our older, legacy leases do not provide the landlord with the right to request utility consumption data and it can therefore be very challenging to collate, this position is however starting to evolve and more tenants are willing to share information. Fidelity International has challenging commitments in place in relation to our own corporate emissions and it is pleasing to know that our real estate Net Zero Carbon Commitment entirely aligns with the corporate position. A further point to consider is the substantial reporting requirements particularly in Europe which will follow in the UK. We are ensuring all systems and processes that are in place across the entire business address likely requirements going forward and allow us to report our progress to investors and regulators.

## How do you encourage sustainability amongst your tenants?

We try to put in a minimum level of green clauses into all of our new leases. We also try to ensure that in any interaction we have with a tenant, we include a conversation around green clauses and wider sustainability issues. We acknowledge that we don't always have the ability to implement new measures at that time, but it has proved a good catalyst for conversation and collaboration. For example, even at rent review, we will ask if tenants will consider adding green lease clauses.

We request copies of actual invoices for electricity, gas, water and waste – this has proved to be a much more reliable way of verifying the data provided. We acknowledge that sometimes the lease provisions can have limitations – some tenants sign up but do not provide their data; others won't sign up but provide their data anyway! It can sometimes be difficult to obtain data from retail occupiers – not because they don't collect it but because they tend to collect it in a certain format and don't want to have the administrative burden of providing different information to what could be tens or hundreds of different landlords across their portfolio.

We also look at our EPCs – recently, on a newly-acquired industrial estate, we inherited EPCs with low D and E ratings. When we instructed new EPC assessments, our more detailed assessments have all come out at a B rating, although no discernible works have been carried out. Instead, the EPC review was carried out in more detail – this result suggests that the original assessments over ten years ago were done quickly and cheaply, so the updated results are beneficial as the asset is now MEES proof through to 2030 and beyond.

We want to help our tenants benefit from lower energy costs. For example, we were looking to add PV panels to roofs at a number of assts. The payback in energy costs can be around 8-10 years, but in one particular case the tenant's lease only had 3 years left to run so we are looking to invest in the PV panels in return for the tenant taking an extended lease. We try to pick those occupiers that are willing to engage and in doing so, we are seeing good results.

## What types of property are you most worried about?

Offices present the greatest opportunity for our building upgrades to deliver real emissions reductions – we would definitely expect to see a benefit from further investing in such property. On a recent project, we took a building virtually back to frame and significantly improved its EPC from E to B. The refurbishment achieved a BREEAM very good certification. It now takes 40% less energy to heat and cool the building and water consumption has been reduced by 20%.

Demonstrating emissions reductions with industrial property can be a little more difficult. Environmental performance can be improved by efficient lighting. Often the warehouse elements of premises are not heated, so improving insulation will have minimal impact. More works may be required in these instances to improve performance, however other improvements can be made installing EV charging points and cycle racks for example.

Retail is the most difficult because retailers often want to put their own stamp on a property with their fit out. We want to minimise occasions where occupiers install inefficient systems.

Currently only around 2 to 3% of existing commercial building stock in developed western economies is already capable of being operated at net zero carbon. There is therefore an enormous task ahead of us. There will need to be investment into the vast majority of buildings that already exist today for retrofitting and substantial improvement works will need to be undertaken. One challenge is that we often have to wait until lease expiry to improve buildings, so that limits the opportunities we have to make the necessary interventions.

## How do you approach development and refurbishment?

We have a working group on sustainable refurbishment which has produced a guide which sets out Fidelity's guiding principles, covering Europe and the UK. We set stringent targets – new developments have to be BREEAM Excellent and EPC A and major redevelopments at least BREEAM Very Good and EPC B. We make sure the whole professional team is aware of these aspirations and on board with the same mindset from the outset.

We then also provide the main contractor with the same guide at point of tender. We make sure our contractors address how to minimise waste from site, use local labour and materials etc. We also ask questions of our suppliers to ensure their policies align with our own.

## Are you seeing properties attracting green premiums or brown discounts?

Green premiums seem to be less and less visible. Green is where occupiers should be at and therefore, rent should in my opinion therefore not be higher for a green building, however on the other hand brown discounts are more and more common in our experience as occupiers are more aware of the additional costs of occupying less efficient buildings. The RICS is scrutinising the approach to accounting for sustainability considerations in valuations and overall we are seeing a flight to quality.

We have found that sustainable refurbishment is not necessarily more costly – quite often, tenant demand dictates the facilities and standards the building must achieve to be marketable and these will, at the same time, meet our sustainability standards. The additional cost however does come from obtaining certification, such as BREEAM, with greater reporting requirements and consultant scrutiny throughout the project.

## What do you see will be the biggest challenges to getting to net zero by 2050?

There is a lack of resources and skills within the industry. The vast majority of buildings will need advice from consultants – how deliverable is our project? How disruptive? How expensive? When should we do it? We're not sure there are currently enough experienced real estate professionals to provide this advice. Also, are there enough contractors and suppliers who can deliver to achieve these high environmental standards available in the market? This is going to be a big challenge for the industry.

## Tell us about some recent projects which demonstrate your commitment to sustainability

Our recent project at Fusion Point 1, Cardiff won Refurbishment of the Year at the Wales Insider Property Awards 2021. The project involved a £6m renovation of 63,000 sq ft. of offices. We achieved BREEAM Very Good, reducing energy consumption by 40% and water use by 20%. We managed to achieve a substantial increase in rent as a result. The entire building was vacant, which helped with the refurbishment programme, though COVID presented it's own challenges. When buildings are partially let, works cannot be done all at once, which slows down the rate improvements can be made.

At Twenty3 in Southampton, we are refurbishing 50,000 sq ft. of offices with completely new M&E, which is much more efficient, new showers, EV charging points and adding an extra storey on top of the building to create an additional 26% floorspace and including winter gardens and business lounges. We are on track to achieve BREEAM Excellent and EPC A and we have secured a pre let to a sustainability consultancy firm at a substantial rent improvement.

Within our industrial portfolio, we are focusing on minimising energy usage, by using LED lighting, reducing water usage etc. Quite often, this will be incremental improvements, rather than whole building refurbishments. At Martland Park, Wigan, we carried out a comprehensive £4.5m refurbishment of 500,000 sq ft of warehouse space, achieving a 45% increase in rental value and 100% uplift in capital value. The improved efficiency and BREEAM Very Good certification played a part in securing a strong tenant for the entire property.

## Get in touch


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For the property industry, the landscape is being redrawn. The effects of the Covid-19 pandemic, combined with longer-term societal changes which are gathering pace, are bringing about a transformation in how we live and work, and how we occupy and use space. Our buildings and communities are being redefined and repurposed. At Mills & Reeve, we are scanning the horizon and Mapping the FutuRE. Visit our city here.