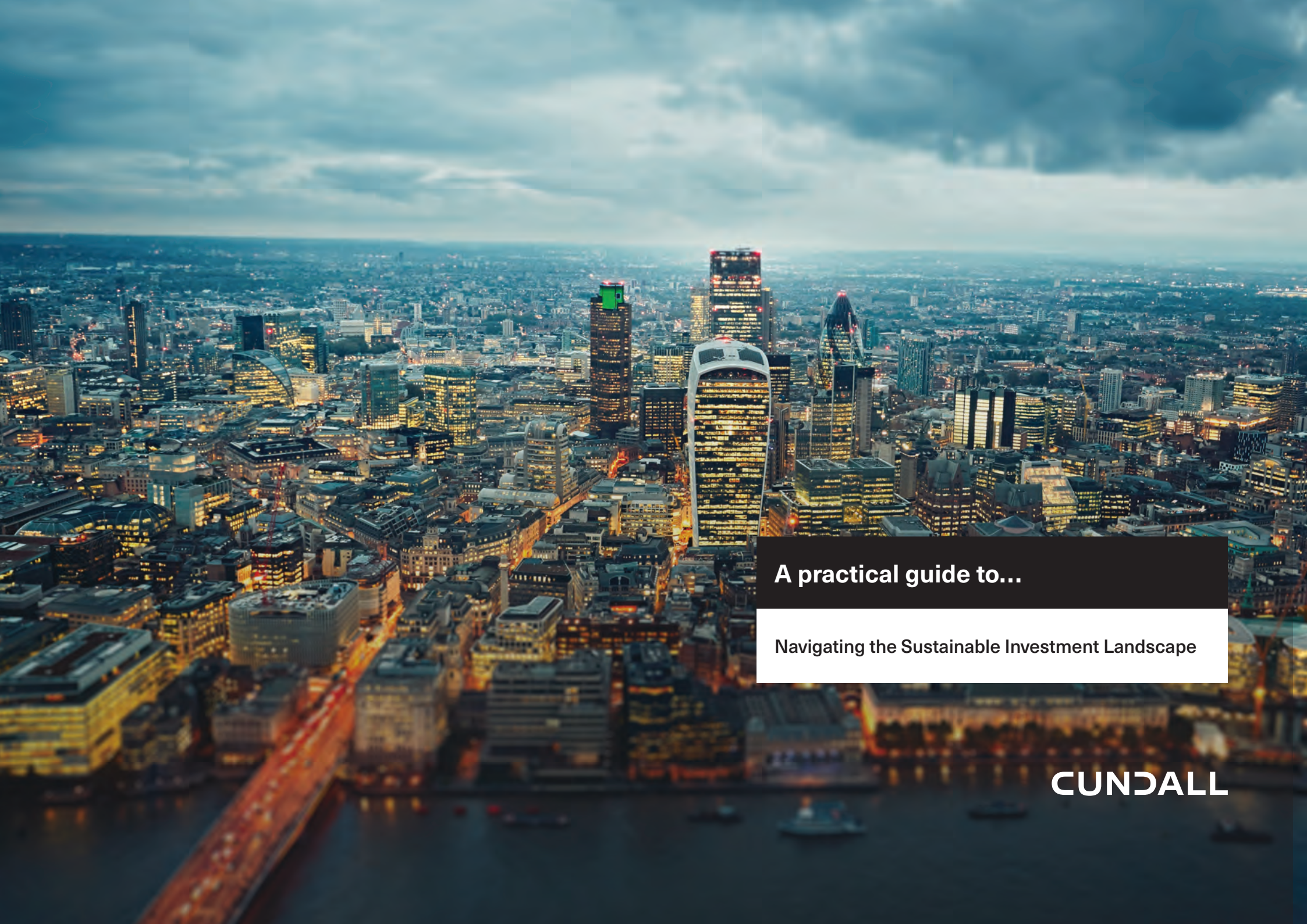


An aerial night view of the London skyline, featuring numerous illuminated skyscrapers and buildings. The River Thames is visible in the foreground, and the city extends into the distance under a cloudy night sky.

A practical guide to...

Navigating the Sustainable Investment Landscape

CUNDALL

Supporting real estate investors to understand and navigate the market and regulatory forces driving the transition to a sustainable, low carbon future.



1. Introduction

The market opportunity and risk of inaction

1.1 Our responsibility to act

Real estate is at the heart of the climate crisis. Investors, asset owners and developers are in the regulatory spotlight and are pivotal actors in the transition to a decarbonised, green global economy.

Sustainability, including climate change, social value, nature impacts, and water stewardship are the defining megatrends of the 21st century.

What we know collectively has not, however, translated into what we do. Despite it being more than three decades since world leaders signed the **Kyoto Protocol**, the corporate and financial sectors have largely failed to act at the scale needed.

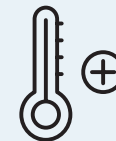
- Fossil fuels still represents 82% of the energy market, down from 85% in 1995. That is a mere 3% fall over the 35 years since the Kyoto Protocol was signed.
- 2023 was 1.48°C warmer than the 1850-1900 pre-industrial level.

- The last nine years were the warmest years on record, the past 10 months were the warmest on record and every single day of the past year saw global average sea temperatures break new records.
- 1 million species are under a threat of extinction.

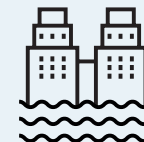
The transition to a net zero carbon economy is a matter of survival. It will affect all nations and all businesses, and we will have to mitigate and adapt to climate change, drastically reduce non-renewable material use, and support meaningful action to enhance biodiversity.



Building materials alone account for more than four times the emissions of air travel.



2023 was 1.48 degrees Celsius warmer than pre-industrialised levels.



Every single day of the past year saw ocean temperatures break new record highs.

Why real estate is ground zero

The real estate industry is the single most significant contributor to climate change after the oil and gas industry, responsible for almost 40% of all carbon emissions. Building materials alone are responsible for 11% of emissions globally - more than four times that of aviation.

We are rapidly moving into the next cycle of economic change, linked to industrial transformation to address climate change, tackle resource depletion and dial back pollution. This is fertile ground for new industries to emerge and thrive. Scientific consensus, global policy, an intensifying investor focus on sustainability, new regulations, rising stakeholder concern and due diligence showing the cost of climate change are all powerful motivations to act.

1.2 Market opportunity

Sustainability is a central driver of value for real estate. Sustainable assets see 10% rental premiums, sales values up 12% and vacancy rates down significantly.

The market for sustainable real estate investments has been experiencing significant growth as investors increasingly prioritise sustainability and ethical considerations.

As of 2023, ESG assets under management (AUM) in real estate are estimated to be over \$2 trillion (a significant portion of the overall ESG investment market which is expected to grow to \$50 trillion by 2025).

The ESG market has been growing rapidly with the Global Sustainable Investment Alliance reporting that sustainable investment in real estate grew by 34% from 2020 to 2022.

And growth is expected to continue at 10% per annum to 2027. The global green building materials market is projected to grow from \$238 billion in 2020 to \$425 billion by 2027, reflecting the increasing demand for sustainable real estate.

ESG real estate investments have shown competitive returns compared to traditional real estate investments.

Studies have indicated that green buildings can command higher rental income, greater property values and reduced vacancy rates as a result of lower operating costs, reduced risk and increased demand from tenants and investors. *Research has shown that green buildings command:

- Rental premiums in the range of 10%.
- Value premiums in the range of 12%.
- Vacancy rates down 13%.

Whilst these statistics reflect numerous drivers, from regulatory pressures, investor demand, operating costs and climate risk the central driver of value as ever comes from tenants.



The Urban Land Institute reports that over two thirds of tenants consider sustainability as an important factor in their leasing decisions; and a more recent survey found that 78% of tenants are indeed willing to pay a premium for sustainable office space.

Overall, the ESG real estate market is on a robust growth trajectory, driven by a combination of regulatory support, investor demand, and the recognised financial benefits of sustainable and responsible real estate practices.



A study by Morgan Stanley found that, in 2023, sustainable funds saw median returns of 12.6% compared to traditional funds' 8.6%."

Mark Carney, governor of the Bank of England

* "The impact of sustainability on value Developing the business case for net zero carbon buildings in central London", JLL Research
"Green building value: do green-rated buildings add a premium to sales price?", Knight Frank Research
"Green Premium, Real Estate and Private Markets", UBS Research
"The Future of Green Permia in Real Estate", Aviva Investors Research

** "Tenant demand for sustainable properties soars", Handelsbanken research

1.3 The risk of inaction

Every dollar invested in climate resilience can yield up to \$10 in financial benefits according to the World Resources Institute*.

Real estate is categorically vulnerable to climate-related risks. Buildings and infrastructure are materially exposed to the impacts of the physical risks and the market responses to loss of value. Also, unlike many other industries that can with relative ease switch suppliers or geographies; almost all the value is locked within assets that cannot move location.

Real estate is also energy-intensive to build and to operate, which means investors and asset owners are vulnerable to policy, market and financial risks associated with the transition to a low carbon economy.

MSCI's Climate Value-at-Risk model estimates that approximately 7.8% of the value in the index could be at risk due to transition or physical risks under the model's default scenarios.

Risk and responsibility translating into reparations and restorative action

Residents of an Indonesian island threatened by rising sea levels took legal action against the cement producer Holcim. The claim for compensation, filed in Switzerland, seeks damages for the negative effects from the climate crisis, compensation for flood defences and demands Holcim cuts its emissions. Holcim is now revolutionising sustainable construction with GO4ZERO, an initiative charting a course towards producing carbon-neutral clinker and cement by 2029. This was just the start of the growth in climate lawsuits, including 2018 cases against governments and organisations in 2022.



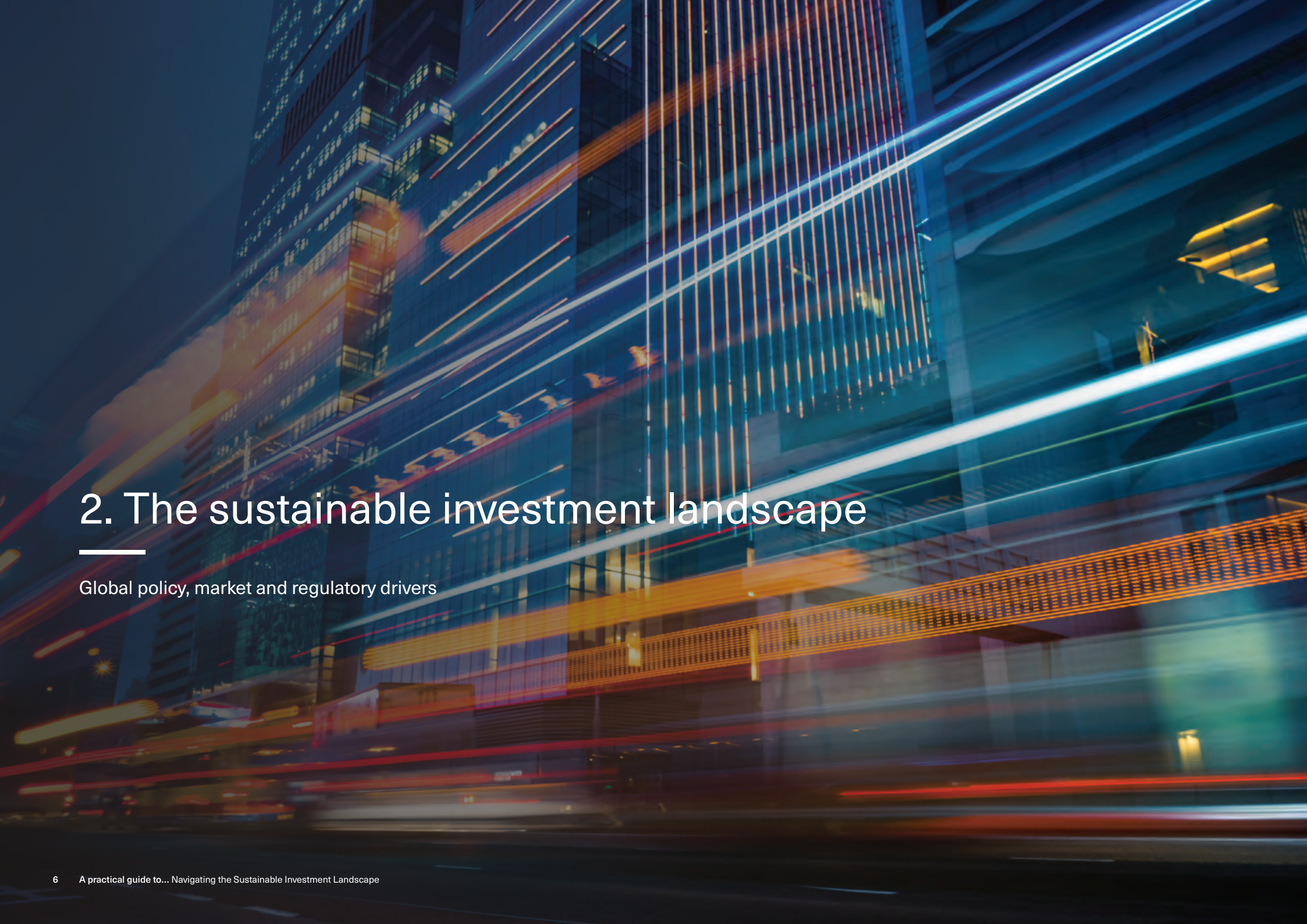
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Firms ignoring the climate crisis will go bankrupt.”

Mark Carney, governor of the Bank of England

*Adaptation, Finance and Investment”, World Resource Institute research





2. The sustainable investment landscape

Global policy, market and regulatory drivers

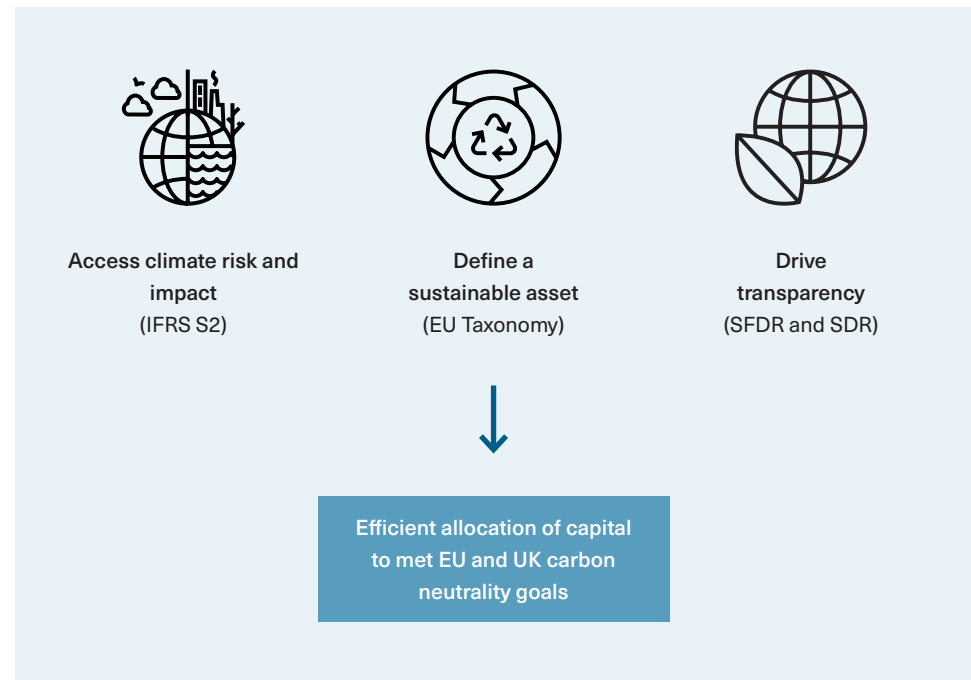
2.1 The regulatory response

To address the interwoven challenges, governments are responding with a tightening regulatory landscape, seeking to dramatically accelerate the allocation of capital towards more sustainable activities.

It is in response to the accelerating threats of climate change (and the failure of the market to respond), that regulators across the world are tightening legislative requirements. The explicit motivations and focus varies across jurisdictions, the US for example focuses on ensuring investors (including asset managers, financial institutions and advisors) are effectively managing risk. In Europe (including the UK) and in parts of Asia, direct mandates have been enacted to take a more comprehensive approach and to green the financial system. In other words, instead of nudging the horse towards water, they are moving the water.

Mandatory climate impact and risk disclosure has been a common focus across key markets including the UK, USA, Canada and Japan. And the Securities and Exchange Commission (SEC) in the US has brought forward proposals to enhance ESG-related disclosures.

Policy measures are also responding to legitimate concerns about the increased prevalence of “greenwashing”. Measures coming into play include demands for increased transparency, credible evidence of sustainability claims in marketing, and distribution restrictions for sustainability-linked products.



All of these sustainable investment regulations aim to direct capital allocations towards sustainable investments, and in doing so, support their governments' sustainability objectives. In the EU for example this is achieved through three key policy tools:

- International Financial Reporting Standards (IFRS) S2 ensures investors understand (and disclose) the financial impacts of climate risk.
- The Sustainable Finance Disclosure Regulations (SFDR) ensure investors provide transparency on their financial products.
- The EU Taxonomy ensures investors understand what constitutes a sustainable investment.

2.2. IFRS 2: Understanding financial impacts of climate risk

Whilst MSCI estimates climate change presents a \$2.2 trillion risk, the IEA highlights that clean technology alone offers a \$1.4 trillion per annum global investment opportunity.

The International Financial Reporting Standards (IFRS) S2, formerly known as “Climate-related Disclosures,” is a set of guidelines developed by the International Sustainability Standards Board (ISSB). It aims to provide a consistent, global framework for companies to report climate-related risks and opportunities. This standard integrates the Task Force on Climate-related Financial Disclosures (TCFD) recommendations established by Mark Carney and Bloomberg. It is part of a broader effort to enhance transparency and accountability in sustainability reporting.

The primary objective of the IFRS is to:

- Enhance understanding and transparency around climate-related risk to ensure better informed investment decisions are made.
- Enhance risk management processes to underpin investor confidence.
- Provide a degree of consistency associated with investment information.
- Recognise that certain externalities are likely to be internalised as the climate crisis escalates.
- Reduce obsolescence and the risk of stranded assets.

References: “World Energy & Investment Report”, International Energy Agency research
“Five Misconceptions About Climate-Change Risk in Real Estate”, MSCI research

Key obligations



Governance

Companies must disclose how their governance structure manages climate risks and opportunities, including board and management roles and responsibilities.



Risk management

Companies must report on how they identify and assess climate related risks, and how these risks are integrated into the organisation’s wider risk management processes.



Business strategy

Companies must explain how climate risk and opportunities affect their business models, strategy and financial plans through a detailed scenario analysis.



Metrics and targets

Companies must disclose metrics used to assess and manage risks and set out the targets along with the performance against those targets.

2.3 EU Taxonomy: Defining sustainability

Sustainable investment taxonomies create a common language to shift trillions towards sustainable investments. The EU is not alone in acting, with 29 taxonomies being initiated or adopted around the world.

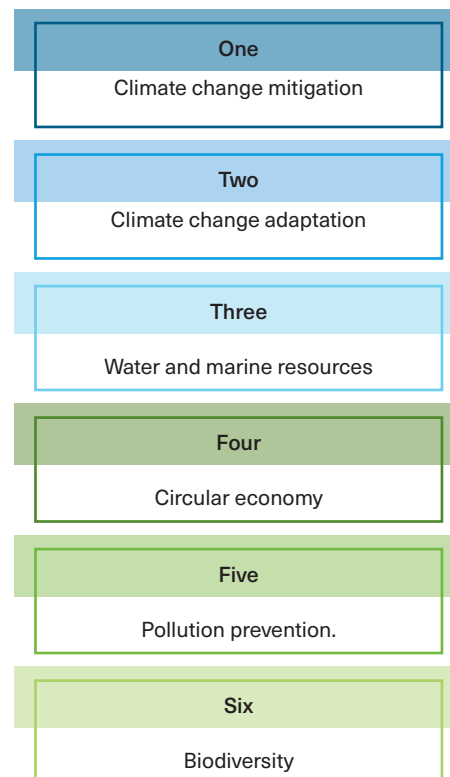
The EU Taxonomy was developed as part of the EU's Sustainable Finance Action Plan.

It is a comprehensive classification system established by the European Union (EU) to facilitate sustainable finance and investment activities.

It aims to provide clarity on what economic activities can be considered sustainable to motivate investment towards positive impact activities. This in turn will promote sustainable economic growth, mitigate climate change, and protect the environment.

Activities within real estate such as “construction of new buildings”, “renovation of existing buildings” and “acquisition and ownership of buildings” each have their own detailed description of what is deemed sustainable.

EU Taxonomy's 6 environmental objectives



What constitutes an EU Taxonomy aligned (“sustainable”) activity within the real estate sector:

Existing assets

For example, existing buildings built before 2021 may only be considered to “align with the EU Taxonomy” if:

- They have an Energy Performance Certificate A rating or are within the top 15% of energy performers in their local market.
- A climate risk assessment has been completed proportionate to the scale of the activity.
- They meet minimum social safeguards.

New developments

For example, new buildings from 2021 may only be considered to “align with the EU Taxonomy” if:

- The primary energy demand is at least 10 % lower than the threshold set for the nearly zero energy building (NZEB) requirements.
- They incorporate a climate risk assessment.
- They minimise water usage, prevent pollution, use sustainable materials and promote circular economy principles and protect biodiversity.
- The life-cycle Global Warming Potential of the building (including embodied carbon) has been calculated and is disclosed to investors and clients on demand.
- They meet minimum social safeguards.

2.4 SFDR: Driving transparency in the market

The SFDR (in the EU) and SDR (in the UK) are taking bold steps to eradicate greenwashing, increase transparency and drive capital allocations into sustainable investments.

The EU's Sustainable Finance Disclosure Regulation (SFDR) was introduced to drive transparency, requiring financial market participants, such as asset managers, investment firms and fund managers, to disclose information on how they are integrating ESG factors into their investment decisions.

Investors must provide detailed fact-based information about their impacts as follows:

- First, investors must establish if their fund has a “Sustainable Investment Objective”:
 - if it “makes sustainable investments with an environmental objective” then it is an Article 9 Fund
 - if it promotes environmental or social characteristics then it should be deemed an Article 8 Fund
 - other funds without sustainable investment objectives are considered Article 6 Funds.
- Investors must disclose the extent to which investments are aligned with the EU Taxonomy
- They must provide pre-contractual disclosures, including information on how sustainability risks and adverse sustainability impacts are considered and integrated into investment decisions.
- Periodic reporting in annual reports and other regulatory filings must be completed, including providing information on methodologies used to assess sustainability risks and impacts, as well as the outcomes of their sustainability-related activities.
- They must also disclose on what are called Principal Adverse Impacts (PAIs)
 - PAIs are impacts of investment decision or advice that results in a negative effect on sustainability factors.
 - There are dozens of PAIs that can be reported, including 14 mandatory environmental and social indicators (such as Scope 1, 2 and 3 GHG emissions, GHG intensity, biodiversity and pay gaps, gender gap and exposure to controversial weapons)
 - Article 8 and Article 9 funds must also complete a benchmarking exercise to disclose their performance relative to that of the market.

Countries around the world are following suit. The UK for example is introducing the Sustainable Disclosure Requirements as follows.

31 May 2024

All FCA regulated firms' sustainability related claims to be clear, fair and not misleading, effective as of 31 May 2024.

31 July 2024

All asset managers must follow labelling and naming rules ("sustainability focus / improver / impact / mixed goals".)

2 December 2024

All products using sustainability-related terms in marketing must include sustainability information in their pre-contractual disclosures by 2 December 2024.

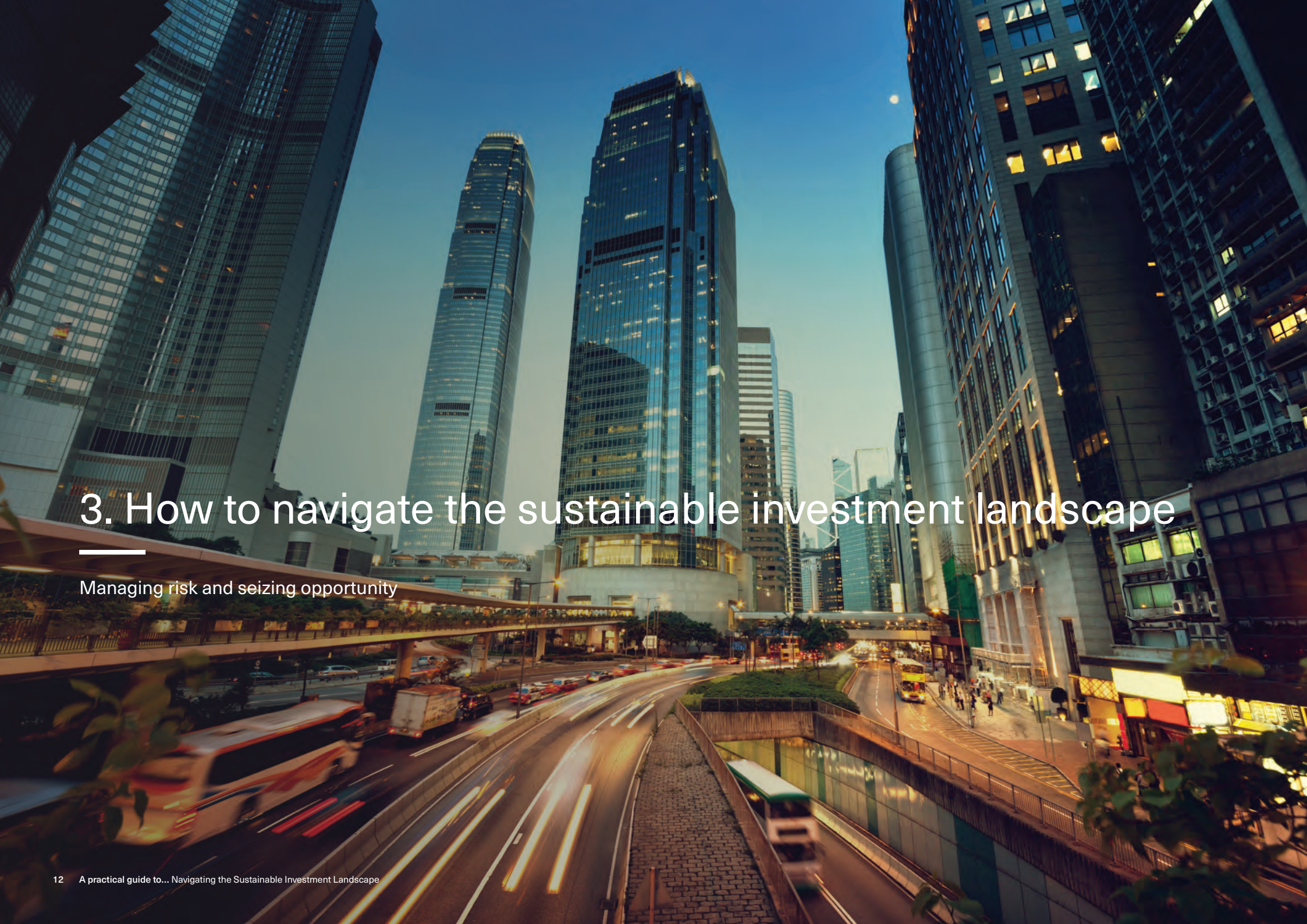
From 2 December 2025

Entity level disclosures (governance, strategy, risk, metrics and targets) and product level disclosure (detailed consumer facing, pre-contractual and periodic disclosures).

For AUM of £50bn

From 31 July 2025

For AUM of £5bn



3. How to navigate the sustainable investment landscape

Managing risk and seizing opportunity

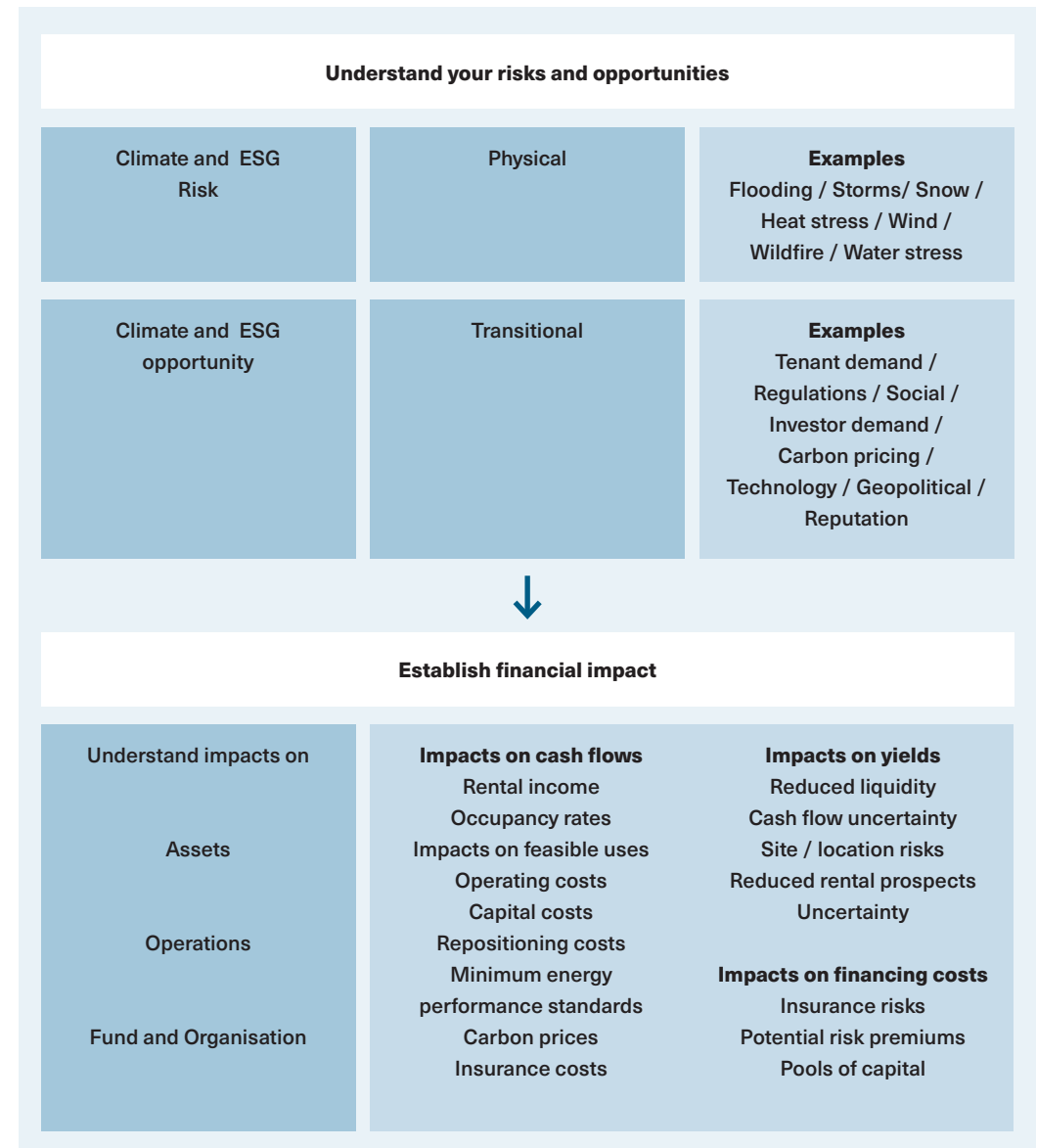
Step 1: Establish the business case

Sustainability strategies must be ambitious and rooted in financial realities.

Sustainability strategies must be ambitious. They must respond to the latest trends, align with industry practice and respond to regulatory drivers. Above all for the strategy to be durable and deliverable; and to stand the test of time it must be rooted in financial realities.

The challenge is that the business case goes far beyond simple pay-back or the analysis of cash flows associated with investments in particular initiatives. And this is where the robust analysis of climate risk (as set out in IFRS S2, and before that – the TCFD) can help. It is essential for organisations to consider the breadth of risks and opportunities, the asset and organisation, the market and operations when considering the business case.

Doing so is essential not just to ensure your strategy focuses on the material issues; it will also ensure that your organisation can unlock the investment needed to deliver on your sustainability strategy and in doing so, to maximise value.



Step 2: Create a positive impact strategy

This is where it gets exciting, as you find the pathway that will address regulatory requirements while also enhancing your alignment with your stakeholders. Sustainability strategy starts with identifying your most pressing material issues.

These are not just the top-of-mind factors such as climate risk, they also include the fundamental concerns that offer opportunities for creating lasting added value and market reputation.

When you know what matters to your clients and influencers, you can shape your strategy to incorporate these touchpoints in targets, metrics, reporting and market positioning.

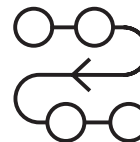
There are six key ingredients to creating a strategy that delivers positive impact and will stand the test of time.



Engage all your stakeholders. Include your investors, your customers, your suppliers, your communities, regulators, and of course your team. Involving the relevant people in the debate is crucial to identifying the issues that will add most value or present the most risk.



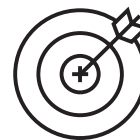
Adopt a dynamic approach to materiality. That means focusing on the issues that are most important to your business and stakeholders, and where your business has the greatest impact (negative or positive) on the environment and on society. It also means extending the timeframe over which impacts are considered material; and being aware that those material issues are likely to change over time.



Invest in engagement, because the process is as important as goals in securing buy-in. It is well known that no initial plan is perfect – effective strategies that have been developed through a robust process, with excellent engagement and considerable communication will ensure your stakeholders remain with you throughout the journey.



Focus on robust plans and deliverables more than on visions, objectives and loose goals. Ambitious sustainability strategies that are underpinned by detailed plans with clear metrics and milestones are essential to enabling action and stakeholders' ability to support delivery.



Create SMART Targets, in addition to an ambitious vision and mission. Sustainability strategies must not just be inspiring. To deliver, they must set specific objectives and incorporate specific, measurable, actionable, realistic and timebound KPIs.



Gather the right data to ensure the strategy can properly address the most pressing strategic issues, to effectively evaluate options and to establish the optimal initiatives and approaches. It is essential also to ensure progress can be properly tracked and hence managed.

Step 3: Engineer solutions into the property lifecycle

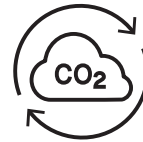
Addressing evolving regulatory requirements and, more importantly, tackling climate change and managing risk is not just a strategic challenge, it is also fundamentally a technical challenge.

The most robust strategies are those that are developed in partnership, bringing together the combined expertise of sustainability professionals, asset and fund managers, finance and engineers.

History has shown that sustainability strategies, net zero carbon definitions, asset repositioning plans and climate risk mitigation approaches that do not secure the proper technical input at the very earliest stages, risk being impractical and more expensive.

As investors respond to the new Taxonomy, to climate risk and to greater pressures from investors, tenants and other stakeholders, it is essential that sustainability and engineering teams work together to embed sustainability standards into each aspect of the property lifecycle as shown.

Meeting regulatory requirements, delivering net zero and tackling climate risk are both a strategic imperative and an engineering challenge



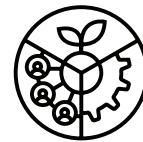
At acquisition, it is important to screen assets for exposure to climate risk; understand alignment to the EU Taxonomy, establish an approximate cost to achieve net zero and understand the building's wider sustainability performance against tenant expectations.



In development and refurbishment, sustainable development standards should be followed, and sustainable design briefs detailed with indicators, performance targets and means of delivering established.



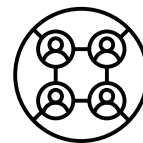
In operation, sustainable asset management plans should be informed by strategic objectives, financial considerations and technical realities; with practical tools to enable property and asset managers to track progress and manage actions to ensure delivery.



At leasing, requirements should be set out that require tenants to operate the building in a way that delivers mutual benefit to both parties, and meets the minimum standards set out in your strategy. Sustainability strategies that do not properly address tenant behaviour and associated performance are of limited benefit.



When developing partnerships, sustainability requirements should be articulated, and expectations of partners agreed. Whether it is joint venture partners, facilities managers or property managers, sustainability requirements are becoming increasingly challenging. Clearly defining roles and requirements from the outset is crucial.



Implement a strategic performance management system. To ensure success and drive delivery, it is important for investors to put in place a system to measure, monitor and report on the progress of the strategy. Doing so ensures the strategy delivers on its goals, or where it fails to do so, corrective action can be taken.

Step 4: Report transparently

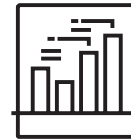
The EU Taxonomy and Sustainable Finance Disclosure Regulations may appear to be a hurdle, however, with an opportunity-minded approach, they can be used by sustainability teams as a tool to enable the organisation to understand its environmental and social impacts and to use these to drive the sustainability strategy and enhance business value.

Leveraging reporting to drive business value

Reporting is not just for compliance purposes. Reporting can drive value multiple ways by using it as a tool to:

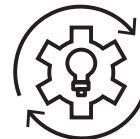
- Inform strategic planning and drive continuous improvement. Sustainability reporting is critical to track progress against targets, to benchmark performance and prioritise action, as well as to generate learning.
- Enables access to a wider pool of capital, customers and talent. Robust reporting demonstrates that sustainability issues are being managed and indicates robust governance. This can increase access to long-term investment opportunities as well as provide access to new customers and talent.
- Secures buy in from staff and other stakeholders. Reporting is essential in keeping stakeholders engaged. No sustainability programme will be successful without engaged staff and partners. Without sharing successes and progress with those stakeholders, support will ebb.
- Provides insight so that better decisions can be made, risks better managed and opportunities identified to drive competitive advantage.

So what are the ingredients for a successful reporting process?



One

Focus reporting on your most material issues.



Two

Establish a data management system.



Three

Ensure data collected is focused on insights needed.



Four

Establish robust governance processes and efficiency.



Five

Focus on stories and outcomes as well as data.



Six

Focus on the process, on transparency and on learning.



Brunel Building London, United Kingdom © Brunel Building

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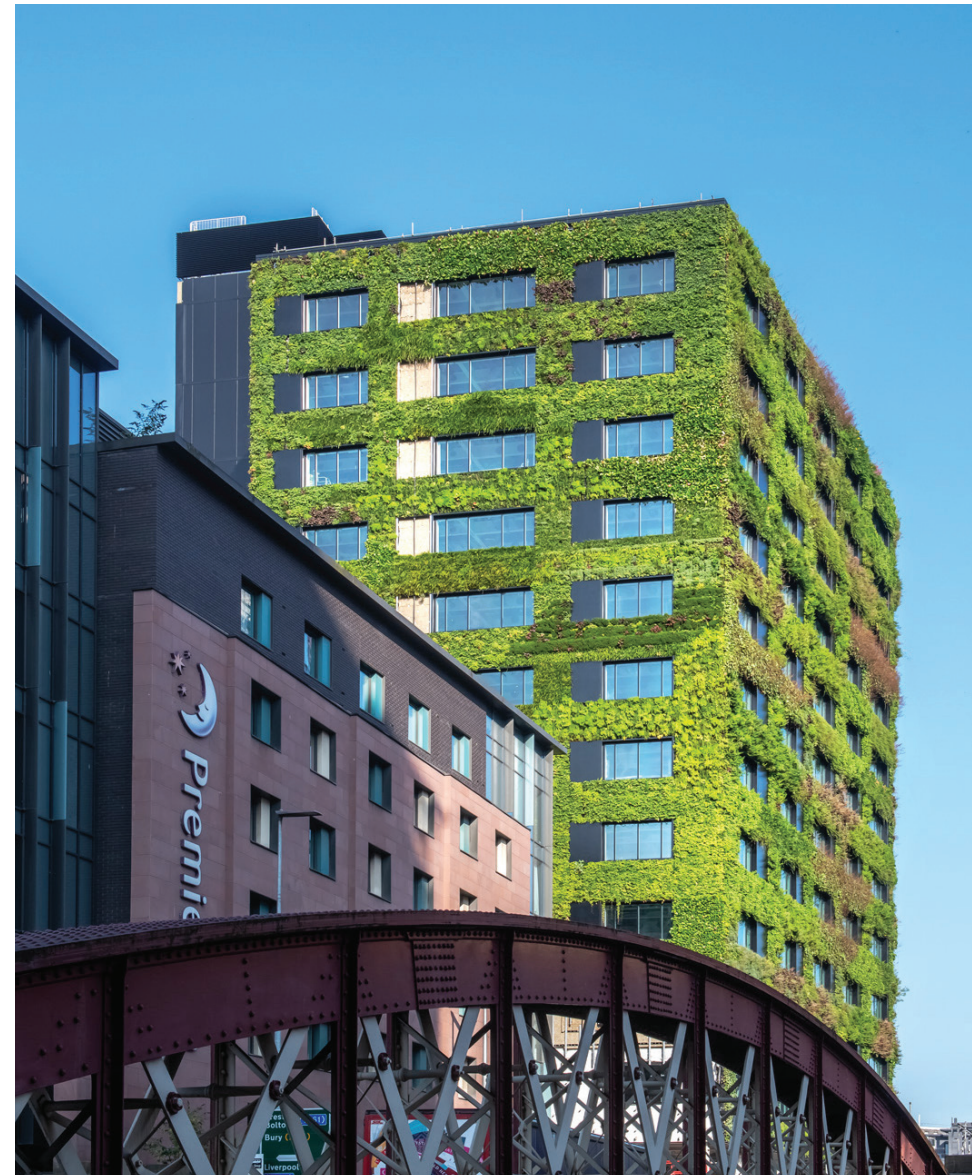


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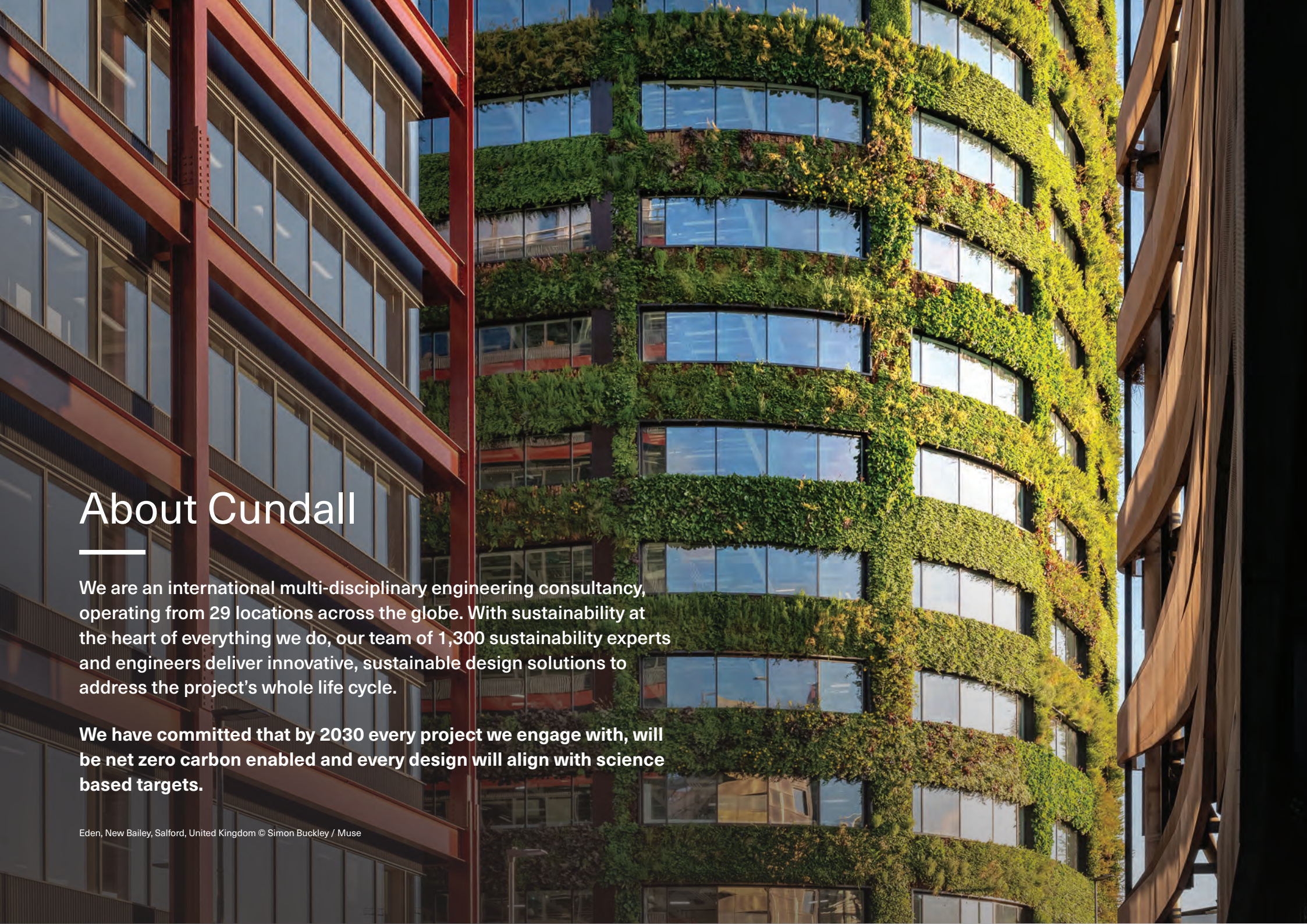
Look out for our next issues of our Sustainability Impact Series - a set of practical guides to managing sustainability risks and opportunities.



www.cundall.com



www.linkedin.com/company/cundall

The background image shows a modern architectural scene. On the left, a building features a prominent red metal frame with multiple levels of glass windows. To the right, a curved building facade is covered in a dense, multi-story vertical garden with various green plants and flowers. The sky is visible in the background between the buildings.

About Cundall

We are an international multi-disciplinary engineering consultancy, operating from 29 locations across the globe. With sustainability at the heart of everything we do, our team of 1,300 sustainability experts and engineers deliver innovative, sustainable design solutions to address the project's whole life cycle.

We have committed that by 2030 every project we engage with, will be net zero carbon enabled and every design will align with science based targets.

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