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Basel Committee on Banking Supervision

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Disclosure of climate related financial risks

We, the Association of Real Estate Funds[1] (AREF), have read with interest the consultation on disclosure of climate-related financial risks. Although banks and the commercial real estate finance market are not within our membership, there are some proposals in this consultation that we believe would not incentivise the right behaviours by the banks and therefore could have an impact on our members. 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. Our Fund Members have taken on board the importance of working towards net zero carbon for the buildings they hold. This needs to be replicated by all stakeholders in the real estate sector to achieve the huge reduction in carbon required.

We understand that CREFC Europe have provided a comprehensive response to the consultation and we would like to support their response. We have highlighted below the key areas that we believe the Basel Committee on Banking Supervision should take into consideration when taking forward the proposals in d560.

Retrofit refurbishment to protect value.

Overtime, all buildings deteriorate and depreciate and therefore need refurbishing and upgrading. The most sustainable option, for many buildings, is to undergo energy efficiency-improvements and emissions-reducing retrofits as part of their natural refurbishment cycle. This is more carbon-efficient than demolishing and building afresh where there is significant cost in terms of embodied carbon.

The disclosure regime should encourage banks to support the decarbonisation of existing buildings. It shouldn't encourage banks to seek to reduce their exposure to older, less energy efficient buildings in favour of exposures to buildings (and indeed asset classes and sectors beyond real estate) that are already efficient, or inherently have low energy usage.

If the whole banking system is encouraged to avoid financing retrofitting that would amount to a significant withdrawal of the lowest cost capital invested in the real estate sector, with potentially problematic second order implications for asset values, the viability of climate risk-conscious and energy efficiency-enhancing refurbishments, and the pace and cost of the decarbonisation of the built environment.

Transition risk reporting

Like CREFC Europe, we are concerned that the reporting requirements in Template CRFR3 "Transition risk – real estate exposures in the mortgage portfolio by energy efficiency level" would encourage banks to minimise the degree to which they have high kWh/m2 to report. This template appears to be a blunt reporting tool which doesn't allow for the range of factors that affect the energy usage and efficiency of buildings.

[1] The Association of Real Estate Funds (AREF) represents the UK real estate funds industry and has over 50 member funds with a collective net asset value of more than £50 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.

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Reporting level of energy efficiency without giving it some context doesn’t seem to be compatible with banks financing low carbon transition, or even simply continuing to lend against buildings whose owners understand the need, and have a plan, to invest in improving their energy performance and resilience to transition risk.

It would be more appropriate for the banks to report (a) whether the owners of the buildings against which the bank has lent have a credible net zero carbon plan (and their record in implementing it); and (b) the degree to which energy efficiency (or other climate risk-mitigating) measures are implemented during the period of the bank’s exposure to a building.

We note that regulations, which require buildings to meet a specified rating or standard in order to be lawfully lettable, have been a very powerful tool for focusing the attention of investors and lenders on energy efficiency/performance and driving investment to improve it. Jurisdictions using such regulations have seen the emergence of ‘green premium’ and/or ‘brown discount’ in property values, reflecting the perceived rental performance and value of buildings by reference to their energy performance.

ESG metrics for real estate

The real estate industry has been developing various frameworks and tools for guiding the transition to net zero of individual assets. One of these, which AREF has supported, is the ESG metrics for real estate. We do not consider that the disclosures proposed by d560 are interoperable with the approaches and metrics emerging from the real estate industry.

Data availability

We note that data availability and data sharing with lenders is a significant challenge in the real estate sector. It’s a problem our Fund Members face every day because data, including in relation to energy, may be protected by privacy laws (such as the EU’s GDPR). There are also considerable challenges in relation to rented commercial property, where building-level emissions data would require building occupiers and building managers and owners to share energy sourcing and consumption data. Therefore, in practice, data sometimes needs to be estimated.

If you would like to engage with us further on our response, please contact either myself (prichards@aref.org.uk) or Jacqui Bungay (jbungay@aref.org.uk), Head of Policy at AREF.

Yours sincerely

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