BMO Commercial Property Trust portfolio decarbonisation commitments: shareholder briefing note

Date: 1st December 2019

Note purpose

The purpose of this note is to provide an overview and update on the commitments made by BCPT to decarbonise the investment property portfolio in line with climate science, with a particular focus on the approach that has been taken to setting carbon reduction targets.

Context

A rapid decarbonisation of the global economy is required if dangerous levels of climate change are to be avoided. The Paris Agreement provides a global mandate for Governments to implement measures to limit average global temperature increases to well below 2°C of pre-industrial levels, whilst pursuing efforts to limit the temperature increase to no more than 1.5°C.

Since the Paris Agreement was established in 2015, a special report by the Intragovernmental Panel on Climate Change (IPCC) has shown that the implications of warming beyond 1.5°C would be more severe than had previously been anticipated. It also concluded that there would be a significant difference in the severity of impacts arising under 1.5°C and 2°C scenarios.

This stark analysis has strengthened global resolve to pursue the more ambitious climate change mitigation goal of limiting average temperature increases to 1.5°C. In the UK, this ambition has been crystallised in an amendment to the Climate Change Act, which now requires the UK Government to reduce net emissions across the whole of the UK economy by 100% by 2050. This effectively means delivering a net zero, or carbon neutral, economy by the middle of the century.

The built environment is the source of around one-fifth of the UK's total greenhouse gas (GHG) emissions.[1] The decarbonisation of residential and non-domestic buildings is, therefore, a key focus of Government policy, with an array of regulations and fiscal instruments targeting the energy and carbon performance of new development and existing buildings already in place. Further strengthening of the policy environment as it relates to new development and the private rented sector is highly likely, irrespective of wider geo-political uncertainty.

Similarly, many investors, including our own shareholders, expect asset managers of commercial property funds to have suitable strategies in place to reduce the carbon impact of their portfolios in line with climate science.

A number of industry initiatives have developed which provide guidance on the scope and suitability of carbon reduction targets, in the context of these international and UK climate change mitigation goals. The Science Based Targets Initiative (SBTI)[2], for instance, sets out a range of acceptable target methods across different sectors, and these have recently been reviewed and updated in light of the evidence provided by the IPCC Special Report. Alongside

[1] https://www.theccc.org.uk/publication/reducing-uk-emissions-2019-progress-report-to-parliament/

[2] The Science Based Targets Initiative is a joint initiative formed by the CDP (formerly Carbon Disclosure Project), the World Wildlife Fund, the World Resource Institute and the United Nations.

published methodologies, the scheme also offers a validation process to verify that commitments made by organisations are indeed in line with climate science.

Alongside the SBTI, the Taskforce on Climate-related Financial Disclosures (TCFD) has developed a framework to support greater consistency across capital markets in the disclosure of the opportunities and risks posed to individual funds and companies as a result of climate change. The purpose is to enable financial markets to suitably account for both the physical risks arising from future climate change, such as extreme weather events and rising temperatures, and transitionary opportunities and risks associated with the shift towards a low carbon economy.

In addition, the majority of the members of the Better Buildings Partnership, a collaboration of the UK's leading commercial property owners and managers, have jointly agreed to publish their own net zero carbon pathways covering both new and existing assets, and to disclose progress against these trajectories on an annual basis.

The UK Green Building Council (UK-GBC) recently proposed the following definition for net zero carbon for operational energy:

"When the amount of carbon emissions associated with the building's operational energy on an annual basis is zero or negative. A net zero carbon building is highly energy efficient and powered from on-site and/or off-site renewable energy sources, with any remaining carbon balance offset."[3]

The approach of BMO Real Estate Partners

The sustainability credentials and commitment to responsible investment espoused by our property manager, BMO Real Estate Partners, is a critical component in the fund's ambition to deliver on its net zero pathway.

BMO Real Estate Partners' Responsible Property Investment (RPI) Framework provides the structure around which the relationships between the various property functions operate, reinforcing the concept that every individual has a part to play and a contribution to make towards the successful integration of sustainability-related matters into property investment activities. Supported by a range of tools to capture and appraise matters relating to energy, carbon and other sustainability characteristics, together with reference to associated guidance, defined policies and procedures, and relationships with key external expert consultants, the property manager is well placed to monitor, report and deliver on the fund's sustainability commitments in a transparent and cohesive manner.

The property manager has recently joined the Better Buildings Partnership recognising that a collaborative approach represents an effective means by which to inform a net zero carbon strategy, and intends to align to the commitments made by existing signatories in developing and publishing a net zero pathway and to the regular reporting of progress against it. These reporting and disclosure obligations would be reflected in the Annual Report & Accounts of BCPT, together with its annual Responsible Property Investment Report.

[3] https://www.ukgbc.org/ukgbc-work/net-zero-carbon-buildings-a-framework-definition/

BMO Commercial Property Trust Ltd commitment

In 2018, in addition to setting annual asset-specific energy reduction targets, BMO Commercial Property Trust (BCPT) Ltd set a carbon reduction ambition in line with science. This follows the commitment the Trust made in 2017 to "set a long-term (2030 or beyond) target for energy (and carbon) reduction according to a recognised science-based targets methodology".

The scope of the BCPT target includes emissions arising within the fund's property assets. This includes all occupier emissions associated with the operation of the properties. This is in line the UKGBC definition cited previously and also aligns with the BBP member commitment published in October 2019.

A series of assumptions used in the analysis are outlined at the end of this note.

BCPT has committed to reduce the energy intensity of assets[4] within the fund by 20% by 2031 compared with 2016 levels. This is equivalent to a 68% reduction in carbon intensity over the same period[5] and also represents a 68% reduction in absolute carbon emissions.

The target is based on an energy intensity metric, rather than carbon, to ensure that BCPT makes a material contribution towards the target's achievement through energy efficiency and demand reduction measures, rather than being wholly reliant on the continued decarbonisation of energy supplies.

The level of ambition of these commitments has been reviewed by industry experts[6] and shown to be comparable with science-based industry standards and the commitments of peers.

Pathway analysis

To demonstrate that the commitments are aligned to science-based industry standards, the BCPT carbon reduction commitments have been compared against SBTI.

Under this method, to align with a decarbonisation pathway that is consistent with the goal of limiting temperature increases to 'well below 2°C', a reduction of at least 38% of absolute Scope 1 and 2 emissions by 2031 against a baseline of 2016 is required. For a target that is consistent with global efforts to limit warming to 1.5°C, an absolute reduction of 63% by 2031 would be required.

The SBTI requirement outlined above includes Scope 1 and 2 emissions. Within property assets this relates to landlord procured energy use, excluding metered occupier demises. As noted previously, the BCPT target includes all energy use, including that of occupiers. To calculate the BCPT target, occupier procured energy use has been estimated and actual landlord procured occupier energy use has been included. The BCPT commitment therefore also includes a portion of Scope 3 emissions relating to occupier energy consumption in buildings.

---

[4] expressed in terms of energy consumption (kWh) per unit Net Lettable Area (m^2)
[5] This has been calculated using location-based electricity emissions factors for the UK
[6] Verco Advisory Services and Hillbreak

The fund commitment is expected to yield a reduction in carbon emissions of 68% in absolute terms. Therefore, even accounting for the increased scope of the BCPT target, the commitment exceeds both of the SBTI thresholds.

It is worth noting in this context that the current efficiency of the portfolio compares favourably to the BBP Real Estate Environmental Benchmark (REEB) 2017. For BCPT, 33% of the directly managed assets for which comparable data exists outperform the BBP Real Estate Environmental Benchmark (REEB) 2017 Best Practice benchmark, whilst a further 44% outperform the Typical Practice benchmark.

In addition to the SBTI methodology, the commitments made by BCPT have been cross referenced for alignment with other emerging industry initiatives. These include the Dutch Green Building Council's definition of net zero carbon buildings in terms of operational energy use, and the benchmarks defined by the EU-funded Carbon Risk Real Estate Monitor project (CRREM[7]). Verco has found the commitments made by the fund to be consistent with these approaches.

Assumptions and methodology notes

1. Analysis was undertaken by Verco Advisory Services.
2. The analysis assumes the same fund composition in 2031 as in 2016, with no net growth in total building floor area over the modelling period.
3. The analysis assumes that emissions produced from the generation of electricity used in the fund's buildings are accounted for using the UK grid intensity factor, based on forecasts produced by the International Energy Agency (IEA CO_2 Emissions from Fuel Combustion, OECD/IEA, Paris, 2016).
4. Data for occupier energy consumption was not available at the time of analysis, and so occupier emissions are estimated. This is done by estimating the energy consumption of property assets using industry-derived benchmarks based on building type.

Further information

Please contact Andy Szyman, Head of Sustainability, BMO Real Estate Partners at aszyman@bmorep.com

[7] The Carbon Risk Real Estate Monitor (CRREM) project provides indicative science-based carbon reduction pathways at the country and asset levels (https://www.crrem.eu/)