UNIVERSITY OF CAMBRIDGE

WOMBLE BOND DICKINSON

ESG: Investing in the built environment

Executive summary

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Environmental, Social and Governance (ESG) principles have gained authority over recent years, and despite a lack of guidance or mandate across UK business sectors, key operations from skills to investment are impacted by ESG decision making. This shift is evident in the built environment sector, where socio-economic and cultural shifts have been steadily gaining at a macro level. An increased focus on the environment and how we want to interact with the space around us, coupled with the rise in popularity for ethical or green investment have further informed the developments that the housebuilding sector delivers.

In this report, international law firm Womble Bond Dickinson commissioned the Cambridge Centre for Housing and Planning Research (CCHPR) to conduct a desk-based, evidence-rich review on how ESG principles are impacting the operations of companies within the UK built environment sector.

Focusing on the real estate, notably housebuilding, and banking and investment sectors, this study draws on academic, grey and market literature to deepen understanding of ESG principles, particularly when it comes to investment decisions that are critical to operations.

re:build Britain

Cambridge Centre for Housing & Planning Research

The key findings from the study are summarised as follows:

Drivers behind the adoption of ESG principles

Delivering value to customers and growing concern for climate change were the two common drivers of ESG adoption in both the housebuilding and banking and investment companies studied. Noted alongside this was the ambition from UK companies to spearhead thought leadership.

Evidence that ESG principles are changing investor priorities

The housebuilding and banking and investment companies studied were shown to have conducted extensive stakeholder engagement as part of the data gathering process for identifying ESG material issues, which included engagement with investors.

The growing importance of sustainability linked and green loans

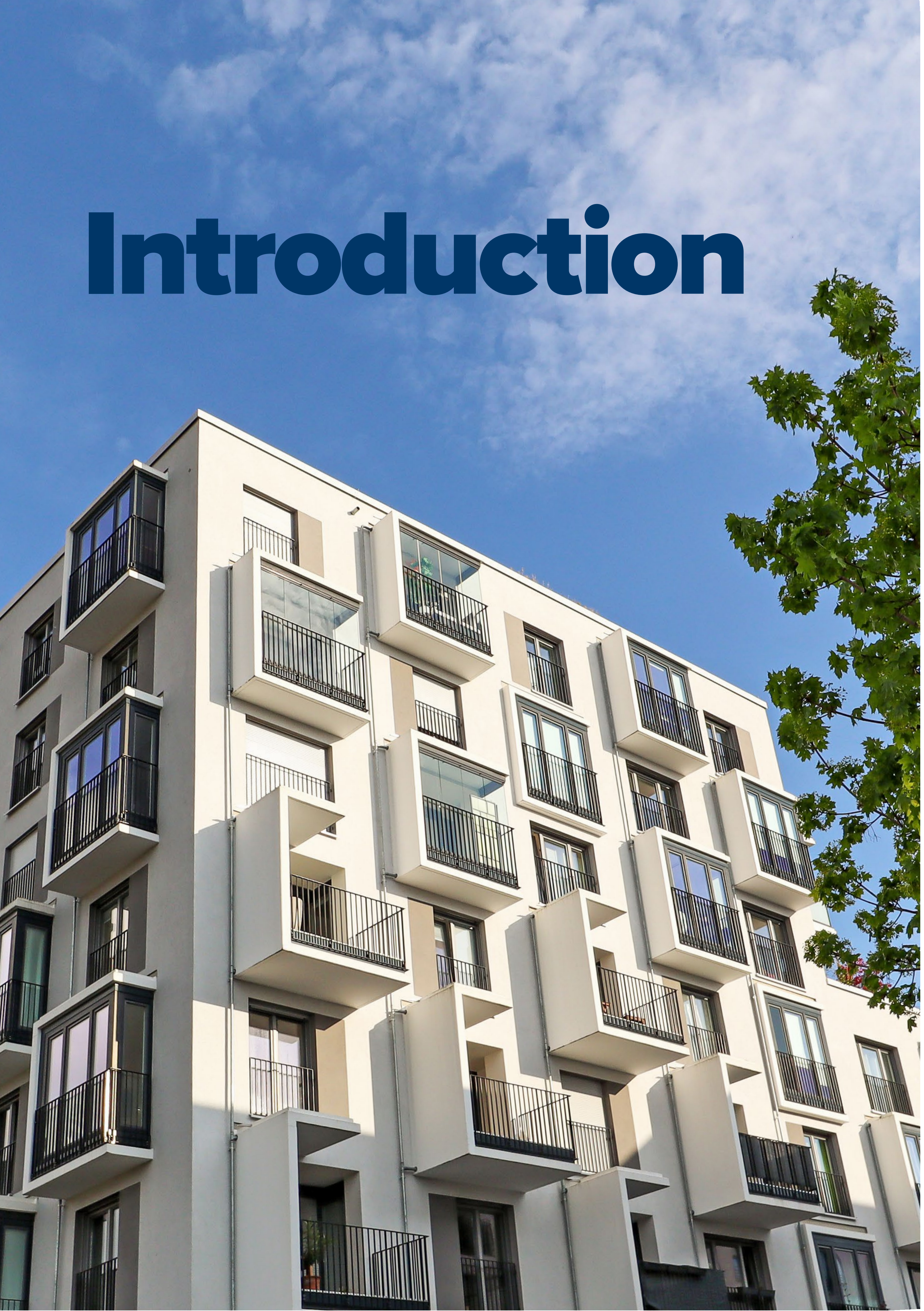
There is rich evidence indicating that banking and investment companies are actively engaged in the issuance of green bonds and sustainability linked loans to support customers' projects under the environmental and social dimensions of ESG.

Gaps in evidence and the need for further research

Despite the evidence that ESG practices are impacting the built environment sector in the UK, there are gaps in the evidence regarding:

1. The social and governance elements of ESG requiring further definition and consistent measurement practices, as found with environmental commitments.
2. How companies can demonstrate that their ESG commitment efforts respond to the different ways that their stakeholders rank ESG material issues.
3. How companies decide what evidence must be captured in an ESG report and the standards adopted during reporting.
4. The differences in how companies' stakeholders rank ESG material issues.
5. How companies can ensure that suppliers are delivering on their own ESG promises, and;
6. The timing uncertainty of the implementation of the proposed UK version of the EU Taxonomy Regulation, which would provide clarity on sustainable activities, disclosure requirements and key performance targets (the UK Green Taxonomy) and changing timescales for embedding any potential legislations.

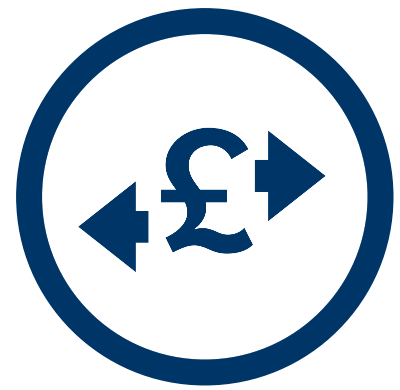
Introduction



This report brings together evidence from two sectors, which have been informally forging their own paths when it comes to ESG-led investment decisions.

Drawing on insights from the ESG reports of companies in the UK:

Where housebuilding forms a key part of the business operations



Companies that operate within the banking and investment sectors

These two sectors are instrumental in the realisation of the built environment through physical development and its financing.

The research approach and its methodology are summarised in the appendix.

ESG: benefits and challenges

What is ESG?

Environmental, Social and Governance (ESG) first appeared in a 2004 report by the UN-Global Compact, which argued that how companies manage their environmental, social and corporate governance issues is an indicator of their management quality. It also argued that companies that take these issues seriously can increase shareholder value and contribute to sustainable development simultaneously.

The report outlined the following issues as falling under the three dimensions of ESG:

	Environmental	Social	Governance
1	Climate change and related risks.	Workplace health and safety.	Board structure and accountability.
2	The need to reduce toxic releases and waste.	Community relations.	Accounting and disclosure practices.
3	Increasing pressure by civil society for companies to improve performance, transparency and accountability, leading to reputation risks if not managed properly.	Human rights issues at company and suppliers' or contractors' premises.	Audit committee structure and independence of auditors.
4	Awareness of emerging markets for environmental services and environment-friendly products.	Government and community relations in operation in developing countries.	Executive compensation.
5		Increasing pressure by civil society for companies to improve performance, transparency and accountability and reputational risks, if not properly managed.	Management of corruption and bribery issues.

Source: *Adapted from UN Global Compact (2004)*

Benefits associated with ESG or sustainable investing

Several benefits were found to be associated with ESG investing, including:

Companies with good ESG scores perform better operationally and are seen to be less risky by investors.

On the stock market, companies that disclose their ESG scores often lower the cost of capital.

Companies reporting better ESG scores avoid sanctions and ultimately improve their corporate reputation by adopting ESG practices.

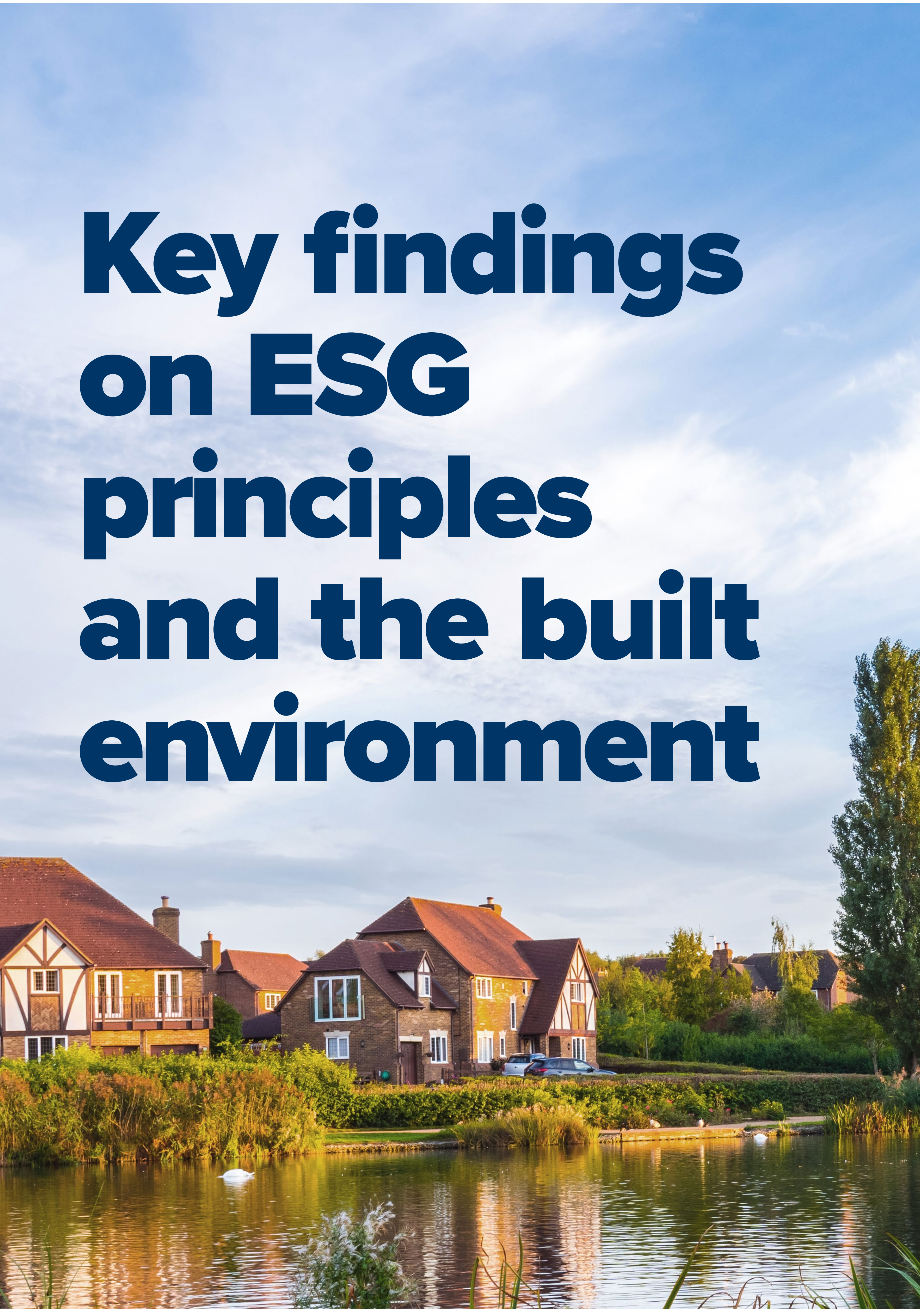
Companies that adopt higher environmental governance than current policy thresholds achieve higher market valuation than those that do the bare minimum.

Challenges associated with ESG investing

Despite these benefits, there are challenges associated with ESG investing. Notable challenges include:

- Investors' prioritisation of one dimension of ESG over the others. A recent survey of 1,000 sustainability investment managers across Europe revealed that overall, investors prioritise the environmental dimension over the other dimensions, although the relative priorities of social and governance vary across different countries.
- Difficulties in defining the remits of issues that should fall under the three dimensions of ESG.
- Methodological challenges are evident in areas such as self-reported data, limited evidence of verification and assurance by third-party auditing bodies, gap-filling by companies selling ESG data, lack of normalisation of datasets to a common benchmark and different timeframes of data capture and updating.
- Lack of clarity regarding industry incentives for engaging in ESG investing, as some companies can stand the stigma of poor environmental stewardship or unethical behaviour, as long as they keep making profits and externalise their cost of operations, and;
- Funders and investors are experiencing a lack of clarity over the content of the UK Green Taxonomy, although it is likely that it will largely mirror the EU Taxonomy Regulation, the majority of which was on-shored as part of the Brexit agreement. Material departures from the EU Taxonomy Regulation are currently unknown, creating uncertainty on reporting requirements going forward.

Key findings on ESG principles and the built environment



Drivers of the adoption of ESG principles among UK housebuilding companies

For the housebuilding companies studied, the primary driver for adopting ESG principles is to deliver value and benefit to stakeholders. Stakeholders included, but were not limited to, customers or households, staff members, local communities, investors, local authorities and regulators.

What customers value

For customers, value is often associated with quality homes that are energy efficient, meet fire standards and are affordable. It also includes responding to customers' needs promptly and improving customers' health and wellbeing through diverse initiatives, such as creating more spaces for nature.

"Achieving our purpose, means building homes and places that enhance people's quality of life and foster local community relationships, and which deliver outcomes that are measurably positive for nature."

Housebuilder 1

What local communities value

All housebuilders recognise the importance of their impact on local communities. Their consideration for this area includes provision of nurseries, GP surgeries and playgrounds for children.

"Creating spaces with a focus on social cohesion within the local community. The focus is on long-term solutions and integrating people into a place, for example, by establishing community centres."

Housebuilder 2

What employees value

For employees, delivering value often includes improved worker retention, offering skills development and training opportunities. For example, housebuilders have increased the number of training days per employees, have focused on the retention and development of apprentices and graduate programme employees, and have continued to introduce and monitor Agile Working Programmes. Housebuilders are also considering how they can embed these values to their supply chain.

> Colleague development provides a systematic, permanent training offer to improve the knowledge and skills of employees and ensures opportunities to advance.
>
> **Housebuilder 2**

Delivering value for the environment

Concerns regarding climate change and the imperative to be good environmental stewards are another driver behind why housebuilding companies in the UK are focused on their ESG practices. It's widely recognised that the housebuilding process contributes to greenhouse gas emissions, including those coming from the companies' operations (scope 1 emissions), raw materials used for the construction process (scope 2 emissions), the value chain used and households occupying buildings (scope 3 emissions).

> As a responsible company, we want to achieve success sustainably and put simply, that means doing the right thing by people and the planet.
>
> **Housebuilder 3**

Delivering value through innovation

Among housebuilders, some indicated their motivation for adopting ESG principles to drive performance standards and be recognised as leaders.

Housebuilding companies in the UK have adopted several approaches to reporting on ESG principles implementation. Common approaches have included the use of statistics on key interventions and commitments made across the different pillars of ESG, as well as case studies showcasing actions being taken relating to the different dimensions of ESG. Whilst there was ample evidence to suggest that companies were delivering on ESG principles in their companies, the following observations could be made:

A lack of formalised reporting for ESG means there is no agreed format on how evidence is presented. For example, whilst some housebuilders provide more details including baseline statistics of current circumstances, as well as targets met to facilitate comparison of their performance over time, others only provide statistics on current activities. For the case studies, only a few housebuilding companies used the Situation, Task, Action, Result (STAR) approach.

Some examples of the issues housebuilding companies focused on under the three dimensions of ESG are summarised below, whilst examples of some case studies are also presented in boxes 1 and 2.

> ...we have always aimed to be leaders and innovators in our sector and this includes environmental and social issues.
>
> **Housebuilder 4**

Examples of issues focused on by Housebuilders in the UK

Environmental	Social	Governance
Energy efficiency, sustainable housing delivery, biodiversity and internal resource use, waste reduction.	Affordable rents for customers, staff wellbeing, inclusion and diversity, community engagement.	Compliance, remuneration, anti-bribery and corruption, reporting and assurance.

Source: *ESG and Sustainability Report of Housebuilders 1, 2, 3 and 4*

How are investor decisions in the UK housing sector informed by ESG principles?

There are several areas where ESG principles inform banking and investment companies' investment decisions in the housing sector. This is reflected in almost every bank having its own products and services that align with ESG measures, largely similar in nature across the board. We also know that almost every bank has appointed a head of ESG, owing to the importance of this to lenders. Products and services identified in the evidence include:

1 Green lending and sustainability-linked loans to support the housing sector

The origination of green and sustainability-linked loans has emerged as an area where ESG considerations are shaping investor decisions. Although there is some recognition that sustainability-linked investment is relatively new to the real estate industry[1], some investors are increasingly adopting ESG principles as part of their companies' strategies. For example, an article by Europa Capital notes that banks are increasingly requesting that loan facility agreements include incentives that are inspired by sustainability-linked targets. This includes improvement in waste diversion, use of green energy and a minimum EPC rating of C for major refurbishment and redevelopment projects.

Similarly, some investors have made specific commitments concerning green lending and sustainability-linked loans. For example, Barclays Bank PLC were originally targeted to facilitate £150bn of social environment and sustainability-linked financing from 2018 to 2025 and have since announced their new target of **$1 trillion of Sustainable and Transition Financing for 2023**[2]. There is also Lloyds Banking Group's £2.1 billion of new funding in 2022 in relation to sustainability improvements in the social housing sector and the bank's Green Building Tool also assessed 240,000 social housing buildings to help housebuilders with funding to continue decarbonisation investments in their projects[3].

2 Supporting standards development in the housebuilding sector

As part of investors' transition strategies to reduce exposure of their equities to climate change risks, there is growing involvement in the development of sustainability-focused frameworks and standards, both internally and externally, to help the housebuilding sector decarbonise.

Some banks now serve as executive committee members of NextGeneration, who have provided a project specific sustainability assessment for housebuilders and are helping to develop new standards that encourage smaller and medium-sized housebuilders to play active roles in realising their sustainability ambitions. For example, Lloyds Banking Group was instrumental in the introduction of two new NextGeneration Benchmarks, namely NextGeneration Core and NextGeneration Project. The former is a sustainability benchmarking system for UK housebuilders that refines the list of existing criteria from the full NextGeneration Benchmark to 14 elements, so that it is relevant for mid-size housebuilders in the housing sector, whilst the latter is a project specific sustainability assessment based upon NextGeneration Benchmark. It contains 12 project specific criteria that makes it a more accessible option than the full benchmark and can be applied to a single project[4]. Housebuilders are thus given awards based on a number of sustainability requirements.

HSBC, Lloyds, Nationwide Building Society, Natwest, Wells Fargo, are also members of the UK Green Building Council, a community of professionals whose mission is to 'radically improve the sustainability of the built environment by transforming the way it is planned, designed, constructed, maintained, repurposed and operated[5].' Members of the Council collaborate, provide skills and share knowledge to create sustainable change and maximise impact in the built environment[6]. The foregoing suggests banks are not only providing sustainability-linked finance but are also contributing towards setting good practices and informing changes in the housebuilding industry.

The evidence points to investors finding ways to support the housebuilding sector by developing sets of frameworks and guidance. However, this adds further complexities to ESG priorities and reporting practices. Housebuilders are left choosing which standards to align themselves to, which could mean missing vital areas where value could be driven for stakeholders. For example, a set of standards set by a bank headquartered in London might not take into consideration the social value that could be achieved at a regional level, where that need is very specific in nature.

Lloyds Banking Group were instrumental in the introduction of two new NextGeneration Benchmarks, namely NextGeneration Core and NextGeneration Project.

3 Encouraging retrofitting and compliance with EPC ratings

Since the passage of the Environment Act 2020, investors are increasingly ensuring that lending for both new and existing residential projects by mortgage customers complies with and encourages higher energy efficiency ratings. As time passes, we are increasingly running the risk of buildings becoming 'unmortgageable' as their energy efficiency rating falls foul of new UK standards. A plan for retrofitting is essential, as the environmental implications of knocking down older buildings in place of new ones are arguably worse than allowing less energy efficient buildings to remain.

For most major banks, there is an ambition to support UK mortgage customers to increase their energy efficiency ratings as well as to encourage customers to purchase energy-efficient homes. For example, the NatWest Group reports that 41.5% of retail banking mortgages are at or above EPC rating C and it has completed £2.9bn of Retail Banking Green Mortgages as of 2022[7].

In 2021, in recognition of the challenges facing residential landlords and housing associations, Lloyds Banking Group provided £2.1bn of new funding, of which £1bn was related to sustainability improvements including supporting retrofit investment and decarbonisation of social homes[8]. It also partnered with a sustainability consultancy firm, CFP Green Building, to give clients access to a new tool to help them identify and understand sustainability and energy efficiency ratings of buildings. Indeed, the Energy Legislation Hub had observed that since the Energy Efficiency in Buildings Regulations were announced in 2015, banks and financiers had changed their position with regard to the purchase of properties, and that some of the largest banks were declining mortgage applications where the EPC rating is as high as D. It further notes that one major finance house has been declining mortgages on commercial buildings that have EPC ratings of C or lower, owing to the amendments to part L of the Building regulations[9].

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4 Investors supporting skills development in the housebuilding sector

Evidence suggests that some investors are supporting skills development in the UK's housebuilding industry to close the future skills gap, which, according to the Future of Skills and Lifelong Learning Evidence Review, amounted to 5% of the employed workforce or jobs at the date of review[10].

The skills gap is partly reflected in the fact that:

1. One third of all employers do not undertake any training of their staff in a given year
2. Nearly a quarter of all jobs vacancies are hard to fill due to skills shortages, and;
3. One in seven employers have some staff who are not fully proficient in their job.

Responding to the skills gap, in 2021 Lloyds Banking Group and Homes England announces a three-year partnership with Regeneration Brainery[11], a property and regeneration training space for school leavers from socially deprived areas to learn and be mentored (and winner of the Social Impact Award at the 2022 ESG Awards). In 2022 Regeneration Brainery reached almost 4000 students via 19 braineries and bootcamps across the UK[12].

5 Supporting scale-up of sustainability-minded SMEs in the construction sector

In line with supporting sustainable construction and green lending, some banks have started supporting small and medium-scale enterprises that are driving sustainable innovation within the construction and housebuilding industry. An example is Panthera, a construction site hoarding and fencing company that has developed an environmentally friendly and re-useable hoarding system to eliminate the use of single-use plywood.

The EnvironHoard system developed by the business achieves a 70% carbon footprint reduction and the business has planted over 1000 trees. Panthera successfully secured funding from HSBC UK's Green SME Fund and received investment advice to help it scale up its current turnover of £1.4m. Just a year into the business, Panthera is said to be receiving interest internationally, including from countries such as Canada, America, Belgium, Ireland and Germany[13].

Evidence of how investor decisions in the housebuilding sector are being informed by ESG principles

Investors in the housebuilding sector are aware that their operations account for more than a third of carbon emissions. Here are some of the ways that ESG principles are shaping their decisions:

1 Declaration of timelines to achieve net zero

In line with the UK government's commitment to achieve net zero carbon emissions by 2050, most investors in the housebuilding industry have also set internal net zero targets and declared when they aim to achieve those targets, including what measures they have or are putting in place to achieve them. Many housebuilders assert that they will reach net zero carbon emissions in its scope 1 and 2 business operations by 2030.

Taylor Wimpey observes that its science-based carbon reduction target, comprising 1.5% of emissions from its operations, 54.8% from its supply chains and 43.6% from the homes it builds, has been approved by the Science Based Target Initiative (SBTI). Bellway has also committed to contributing to the UK's target of net zero by 2050. Despite these commitments, NextGeneration notes in its 2022 report that only eight housebuilders that have been benchmarked have a net zero carbon home target and that there is a lack of clarity on how these targets will be met[14].

2 Reporting and growing commitment to reducing scope 1 and 2 emissions

Another area where the decisions of investors are being informed by ESG principles is increasing reporting on scope 1 and 2 carbon emissions and committing to reduce embodied and operational carbon from the homes they build and their business operations.

For example, Taylor Wimpey reports in 2022 its total verified scope 4 and 2 emissions footprint was 20,254 tCO2e and 18,306 tCO2e, estimated using both the location-based and market-based methods respectively. Similarly, Bellway has committed in it 2022 Annual Report to reduce its direct carbon emission intensity from construction operations, offices, and business mileage (i.e. scope 1 and 2 emissions) by 46% by 2030.

The Hill Group also reported that in 2022 the total carbon emissions from its new homes amounted to 127,973 tCO2e and subsequently it has developed a roadmap for reducing the operational carbon emissions of its homes by 2030. Initiatives being taken to reduce carbon emissions include, but are not limited to fabric first standard schemes, and integrated low carbon electricity and air source heat pumps (The Hill Group, 2021).

Despite these changes in investors' decisions, NextGeneration observes that only 6 out of 28 benchmarked housebuilders have set a target to reduce their water consumption and only one has demonstrated a 3% reduction in water consumption across its sites and offices over the past year.

3 Increasing uptake of sustainable construction

Sustainable construction is also rapidly becoming an area where ESG principles, particularly the environmental dimension, are impacting investors' decisions. This relates to the adoption of innovative construction techniques that promote safety, save time, and are less costly to produce and run. For example, as part of its sustainable construction, Bellway uses modern methods of construction (MMC) to deliver some of its homes. It also uses other sustainability-friendly approaches like ThermaQ heating controls for heating its new homes, structural insulating panels for heat retention, less carbon-intensive concrete bricks for walling, showersave for heat recovery, air source heat pumps, ground source heat pumps and electric boiler solutions for space heating.

Commercial lending for MMC projects has increased as more knowledge and experience of the build continues to grow, housebuilders can easily gain this investment based on reputable management teams, access to capital and credit records.

Similarly, in 2021, The Hill Group met the space heating requirement in more than 300 of its homes that were under construction through air source heat pumps. Places for People is also ensuring that the construction of all its new homes will achieve an EPC rating of B or above[15].

4 Investment in wildlife enhancement and biodiversity

Evidence suggests that investor decisions in the sector are also being informed by concerns for wildlife and biodiversity loss. Consequently, some housebuilders have committed to different initiatives that aim at integrating biodiversity gain into their projects. For example, Bellway aims to achieve a 10% 'biodiversity net gain' on all new sites submitted for planning application from 2023 onwards. The company has also partnered with nature charities to investigate biodiversity and carbon offsetting opportunities. Taylor Wimpey has been developing metrics to enable it to assess the biodiversity net gain of its sites. It has also developed a Home for Nature Toolkit that offers practical ideas, costs and guidance to help its team to implement relevant biodiversity enhancement measures. As of 2022,the company had 151 sites installed with a hedgehog highway[16].

5 Responsible procurement and supply chain diversity

Another area where ESG principles are informing investor decisions in the sector is responsible procurement and supply chain management. Almost all housebuilders emphasised the importance of ensuring that ESG principles – such as fair wages, payment of taxes, modern-day slavery – and regulatory compliances are adhered to within their supply chains.

Bellway observes that it obtains 100% of its timber from certified sustainable sources and is a signatory to the Prompt Payment Code. For example, in the first half of 2020 Bellway paid subcontractors within an average of 35 days and 34 days in the second half of the year.

Places for People actively encourages smaller businesses to apply to join its supply chain to promote local business initiatives in the UK. In 2020/21 the company spent more than 40 per cent of its £600m turnover on SMEs.

NextGeneration, however, asserts that only 11 out of 28 of its benchmarked housebuilders are now complying with sustainable procurement in their supply chains. Whilst some investors have developed elaborate protocols to ensure responsible procurement within their supply chains, others remain vague in this area.

Many housebuilders assert that they will reach net zero carbon emissions in its scope 1 and 2 business operations by 2030.

How have companies in the UK housing sector embedded ESG principles across their companies' values and practices?

The Global Compact and Principles of Responsible Investment define the scope of issues relevant to ESG. These include human rights, labour dignity, environmental stewardship, anti-corruption, reporting and disclosures. There is evidence that companies in the housebuilding sector have started to embed ESG principles into their values and practices.

Housebuilding companies are demonstrating the importance of ESG through increased reporting on their ESG-related practices and achievements against international conventions, like the UN-Sustainability Goals and sector-specific benchmarks and frameworks.

Housebuilding companies are demonstrating the importance of ESG through increased reporting on their ESG-related practices and achievements against international conventions, like the UN-Sustainability Goals and sector-specific benchmarks and frameworks. For example, in its 2022 Sustainability Supplement and ESG Addendum, Taylor Wimpey observes that it supports the UN Sustainable Development Goals, which aim to unite governments, businesses and the third sector to end poverty. In 2021, Places for People committed to enhancing its approach to sustainability and ESG reporting and pursuant to this, the company introduced the Certified Housing Label (CSHL) to independently validate its work. The CSHL, the company notes, has been developed to attract ESG investors who want to make positive impact into the debt capital markets. The company has achieved the Frontrunner ranking in the social dimension and an Ambassador status ranking in the Environmental and Governance dimension, and is committed to doing even better.

In relation to human rights and labour dignity, most companies are promoting inclusion and diversity, upskilling and wellbeing among their staff. For example, Taylor Wimpey has signed up for the UK Government's Disability Confident Scheme and is a Stonewall LGBTQ+ Diversity Champion.

Regarding environmental stewardship, most housebuilding companies are focusing on nature in their developments. For example Places for People has created customer gardens and wildflower meadows to promote biodiversity. Also, as earlier mentioned, most housebuilding companies have now begun reporting carbon emissions from their business operations and from the homes they build (Scope 1 and 2 emissions).

What is the evidence that ESG principles are changing the nature of investment in the UK housing sector?

The impact of ESG principles on the nature of investment in the housing sector can be seen in many areas – the types of materials used for construction, initiatives to reduce waste during construction and the adoption of construction and finishing approaches that generate renewable energy, achieve energy efficiency and thermal comfort, etc.

Taylor Wimpey has conducted research to update the technical specification for its homes in preparation for the Future Home Standard. Also, from June 2022, the company's new homes had enhanced fabric standards following the coming into force of Part L of building regulations.

From a social point of view, housebuilders are investing more in communities. For example, Places for People launched the #SocialSpace initiative, which helps charities and local enterprises to establish themselves in local communities. It offers premium commercial space at flexible and reasonable rates, development advice, training and mentoring.

Case Study: Hill SoloHaus

In 2018, in honour of its 20th anniversary celebrations, Hill committed to a £15 million project to deliver 200 modular homes for homeless people over the next five years, an initiative known as Foundation 200. Each modular home, or SoloHaus, has been designed with sustainability and energy efficiency at its core, with the electricity costing only £5 per week to run.

The 24sqm living space needs only electric, water and waste connections and is heated via a heat pump which can service six homes. The modular design and assembly, powered by Modern Methods of Construction (MMC), means that a SoloHaus can be manufactured in just 20 days in a factory-controlled setting with the added ease of consistent quality checking and is delivered on a single lorry. Kings Hedges, Abbey, and Chesterton in Cambridge are now host to a SoloHaus development[17].

"Since 2020, 52 homes have been installed free of charge in locations in England. To date, 104 of the 200 homes have been allocated. During 2023, in collaboration with local authorities and charities, an additional 62 homes have been allocated to sites on behalf of Hill's partner charities."
(Hill ESG Report 2022)

What impact is this change having on the development trajectories of companies in the UK housing sector, if any?

ESG principles are impacting the development trajectories in the housing sector. One clear signal of this can be seen in national legislation, policies and standards including the Environment Act of 2021[18], the Net Zero Strategy[19], the Heat and Buildings Strategy[20], and the Future Homes Standard, which emphasise sustainability.

For example, in order to access sustainability-linked loans, some financial and investment companies now require their customers, including private landlords, housebuilders and prospective homeowners to demonstrate how their projects meet the bank's internal sustainable finance requirements.

It is seen that banks are now creating bespoke frameworks for the residential housebuilding sector. Hence, investors willing to access this sustainability-linked finance will have to change their development trajectories. A Barclays Bank report which asked 150 ultra-high-net-worth (UHNW) investors, who have an average portfolio of US$730m,

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what proportion of their portfolios are held in sustainable investment and how they see that evolving in the future. The survey found that 32% channelled their investment into sustainable investment at the end of 2021, with an expectation to grow this to 50% in five years. Also, 72% of UHNW investors who identify as traditional investors say they include ESG factors in their investment decisions. This sends strong signals to the actors in the housing market[21].

Furthermore, in the buy-to-let market for example, the National Residential Landlords Association advises that rental properties are likely to be required to have an EPC rating of C or higher. Therefore, landlords should only purchase properties that are compliant unless they have a clear plan for a refurbishment. They further advise that landlords start considering how easy it would be for them to switch their properties to carbon-neutral heating when looking at potential investments[22].

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How can investors in the UK housing sector be sure that ESG promises are delivered upon?

Ensuring that ESG promises are being delivered is not always an easy undertaking. This is partly because ESG brings together three main factors – environmental, social and governance, each of which has different sub-categories and measuring indicators that are not universally agreed upon[23].

It is however clear that of the three pillars, there seems to be more consensus around metrics for measuring impact in the environmental dimension[24]. For example, it has become a standard practice for companies to measure and report on carbon emissions from both their operations (scope 1 and 2) and supply chains (scope 3). As has been highlighted earlier, almost all housebuilders now report their scope 1 and 2 emissions, highlighting targets set and their achievements to date. Some housebuilders also report where they fall short of their carbon targets and what they will be doing to improve going forward. Investors can refer to companies' environmental performance in these documents to inform themselves of whether companies they invest in are delivering on at least the environmental dimension of ESG.

The key findings from the study are summarised as follows:

Tackling greenwashing with checks and balances

A growing concern for investors is greenwashing. Defined as the 'creation or propagation of an unfounded or misleading environmentalist image', it significantly derails the ambition and drive to achieve net zero. The World Economic Forum offers five recommendations to tackle greenwashing[25].

1. Investors should check that organisations have announced a net-zero pledge with targets for 2025, 2030 and 2035. The pledge should demonstrate that the organisation will achieve a 50% cut in global carbon emissions by 2030 and will sustain it after 2050.
2. Investors should check that organisations have created a transition plan, as it is too easy to set targets. Transition plans should be regularly updated to make pledges concrete, while also highlighting uncertainties, assumptions and barriers.
3. Investors should check that organisations are transparent and accountable. They should look out for whether the public has to face a paywall in order to access information about pledges, targets and plans. Investors should also check that organisations publish annual climate reports with baseline data for comparison.
4. Investors should check for organisations' plans and commitments to phase out fossil fuels and scale up renewable energy, and;
5. Investors should check whether organisations are using voluntary carbon credits to offset their emissions and whether the beneficiary benefits are indeed reducing their emissions.

Making sense of social impact

Unlike the environmental and governance dimensions, there is less consensus around the scope of social issues and guidance for community engagement. Some housebuilders, however, appear to be making good progress in the social pillar and report on charitable giving and other investments into social enterprises. However, the endemic nature of some social problems, such as poverty and deprivation, make it difficult to judge whether interventions by housebuilders in the name of ESG are tokenistic or make material changes in the lives of people and communities, without guidance or cohesion on reporting. This is a question that requires empirical examination. Although, many housebuilders are taking their own initiative in designing projects that fall within the social pillar. For example, Grainger PLC has developed a best practice Blueprint for Community Engagement, which sets out a leading approach to link up community engagement at all stages in the development of a new building - from planning to operation[26].

Good corporate governance requires clearer taxonomy

In terms of governance, good corporate governance practices – such as taxation, anti-corruption, money-laundering, regulatory compliance, modern-day slavery, fair wage, non-discrimination etc. – are reasonably well-established in most jurisdictions and often captured in companies' annual reports. For example, Places for People adopted the UK Corporate Governance Code (the 2018 version) and in the 2021 financial year, reported compliance against several provisions. Taylor Wimpey provides annual training to its staff on anti-corruption policy. It also has whistleblowing procedures for employees, subcontractors, suppliers, customers and the general public. Investors can therefore consult these reports to find out how the companies they invest in are mitigating or handling governance issues.

Gaps in evidence and areas for future research

ESG commitments and how the sector responds to ESG materiality issues

Whilst there is no shortage of evidence that ESG commitments are a priority for the sector and being delivered on in both the housebuilding and banking and investment companies studied, there is a lack of clarity regarding the following:

- How disparities in stakeholders' ranking of ESG material issues are reconciled.
- How companies distinguish between commitments that respond directly to the ESG issues agreed after the materiality assessment from wider business operations, and;
- How companies can be sure that ESG promises are being delivered upon by their suppliers.

Uncertainties regarding ESG governance in overall corporate governance

Although there is evidence that companies are either adapting their existing governance frameworks, or creating new ones to oversee the embedding and implementation of ESG principles, it is mostly not clear where ESG governance sits within companies' overall governance frameworks, and whether there is a dedicated in-house ESG team adequately resourced to focus on ESG issues exclusively.

The lack of clarity and guidance surrounding the UK Green Taxonomy needs to be resolved at government level; the delay in bringing the new legislation into force is leading to diverse reporting from banks and lenders. Changes to the implementation roadmap need to be first addressed and then recommitted to time scales. Embedding the new legislation will impact companies greatly and require organisational change.

Unequal attention to the three dimensions of ESGs

Consistent with observations made elsewhere, there appears to be unequal attention given to the three dimensions of ESG, as the environmental dimension often remains dominant. This dominance can be seen in terms of the mandatory climate disclosures, matrices developed to measure and report different scopes of carbon emissions and the elaborateness of case studies on climate interventions. Further work will therefore be needed to understand why more attention is given to the environmental dimension, and less to the social and governance pillars of ESG.

It is clear that participants in the real estate sector, including housebuilders and their funders, are increasingly adopting ESG principles to deliver value and benefit to their customers, communities and stakeholders. Clarity introduced by a UK Green Taxonomy as well as market standard wording in funding documents issued by the loan market association will only serve to increase this engagement moving forward.

Next steps

Womble Bond Dickinson will follow up on this report with further updates from the banking, real estate, construction and planning teams on developments in this space as well as through client events, including a roundtable event on ESG funding issues following publication of this report. Team members from across the firm will also provide further insights on ESG issues across our other business areas, including collaboration with our colleagues in the US, via the ESG hub on our website.

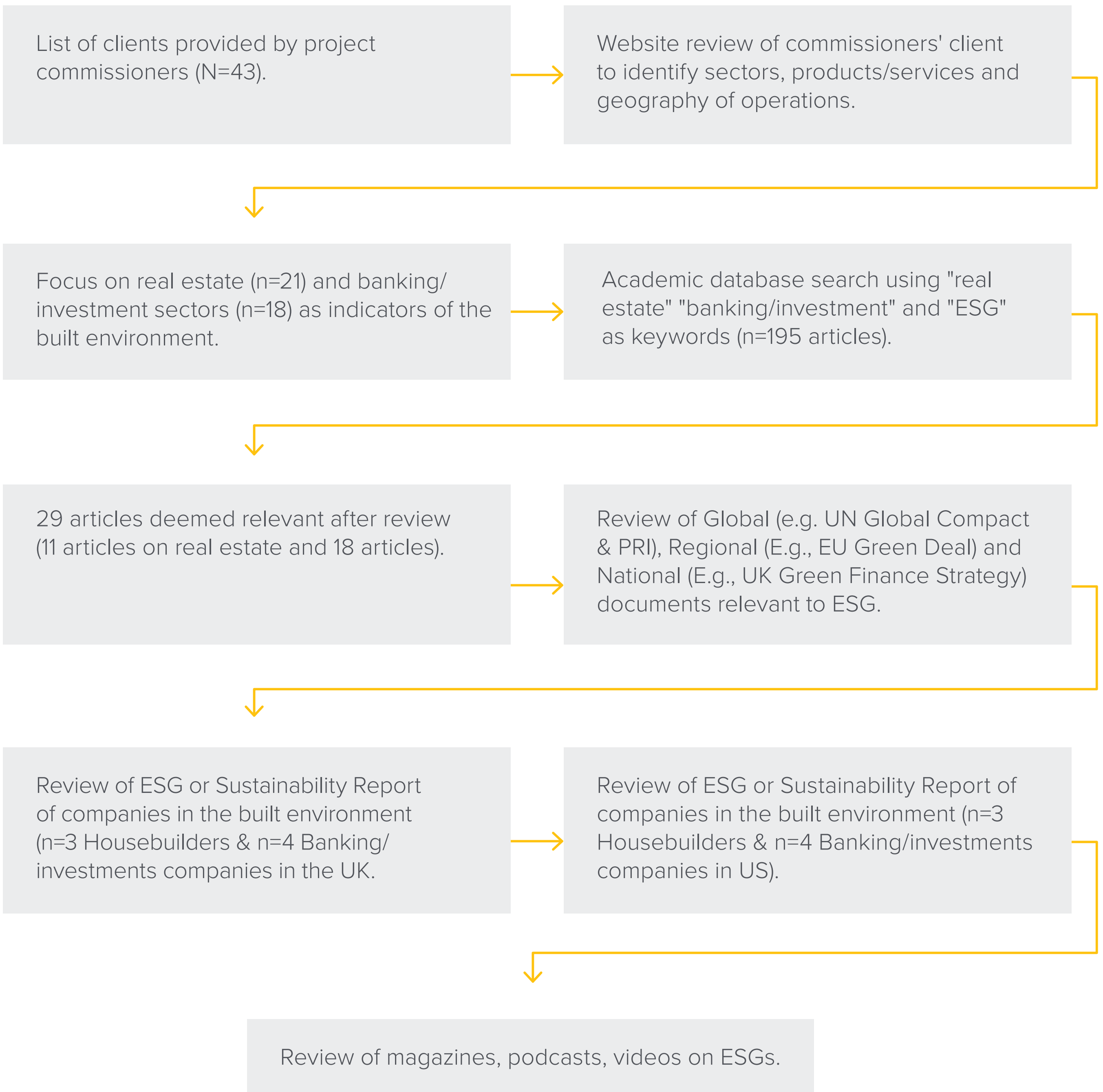
Appendix

Research approach

The report adopted a qualitative research methodology anchored on a desk-based review of secondary data sources. The research methodology and data sources drawn upon are summarised in Figure 2 below. It is worth mentioning that the scope of the review was limited to the built environment, which includes all elements of human-made infrastructure and buildings (UKGC, 2021).

Hence in this report, the built environment has been operationalised by the housebuilding and banking/investment sectors because of the synergistic relationship between both sectors in creating the built environment and the contribution of the housebuilding industry towards greenhouse emissions (currently about 35%). It is also worth mentioning that the academic literature tended to take a market rather than a company operational focus and largely modelled statistical relationships between various aspects of both the housebuilding and banking/investment sectors and ESG investing. Hence, the insights presented in this report derive from the recent (2021) ESG or sustainability reports of housebuilding and banking and investment companies in the UK and US.

Schema showing the research methodology and data source



Source: *Authors*

Footnotes

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