#FORSustainability

Guidance Note – Residential ESG

HOW IS ESG BEING INCORPORATED INTO THE RESIDENTIAL REAL ESTATE MARKET FROM A LEGAL PERSPECTIVE?

Environmental

- Green lease provisions.
- Energy efficiency within residential estates is very important. This often requires district heating systems which require an energy services company (ESCO) to run them. Concession agreements, complicated leases and deeds of easement are put in place to grant the necessary rights to the ESCO.

Social

- Building safety and standards – refurbishments and control of damp and mould.
- Place creation – short term licences to permit meanwhile uses at estates.
- Community engagement – establishing a resident's charter or estate initiatives and requiring person's bulk buying into an estate to adhere to those.

Governance

- Encouraging diversity within boards of residential developers.
- Engagement between the board and residents.
- Ensuring that internal policies, such as modern slavery are up to date and implemented within supply chains that support residential developments or estates.

GREEN LEASE CLAUSES

Within the commercial real estate sector, inclusion of green lease clauses is becoming more common and there has been reference to a broader range of "rainbow lease" clauses that pick up not just environmental aspects, but also the social and governance aspects. However, within the residential real estate sector, the adoption of green lease provisions or wider ESG clauses has been slower. This is partly because many of the leases granted are long leases whose terms are not renewed as frequently as commercial leases, but also the position is arguably more complicated for the residential sector for the following reasons:

- Residential premises cannot be easily accessed (for example for the purposes of retrofitting) with the tenant in place, particularly as the landlord will need to access someone's home. The intrusion is personal and so it is more difficult to have buy-in from leaseholders to agree such a right.
- Similarly, restrictions on alterations or requirements around fittings within a home are also more controversial when the tenant owns a long-term capital interest in a property. There may be the view that they should be able to act as they see fit within their home.
- Potentially more contentious than access is the cost of such works if the proposal is for energy efficiency works to be paid for through the service charge. There is however the counter argument that the tenant will save money long term from reduced energy bills.

- There is a diverse range of residential property landlords (arguably more so than with commercial property). For example, 19% of housing in England is within the **private rented sector**. As such, the approach to documenting residential occupations varies significantly between sectors.
- The commercial sector benefits from tenants often looking to meet their own ESG corporate criteria and so the landlord's and tenant's priorities are aligned. Whereas each individual residential tenant may have a different view on their priorities in respect of environmental policy.
- Within green lease provisions, there is a focus on the right to collect data from tenants. This is usually around energy usage, but it could be a broader set of information to assist with tracking the sustainability of a property. However, collecting data from individual residential tenants also means that landlords need to be careful to ensure compliance with data protection law (UK GDPR). Residential tenants may be more cautious to agree to such rights of data collection in order to protect their personal data.

Despite the challenges relating to adopting green lease clauses, there has been some adoption of green lease clauses within new-build residential estates. The areas they focus on are:

- Enabling collection of energy usage data by the landlord.
- Engagement with environmental initiatives on the estate.
- Encouraging the adoption of renewable energy supplier.
- Restrictions on undertaking alterations that undermine the energy efficiency rating of the premises.

Where green lease clauses are being adopted they appear to be in new estates where estate owners are themselves committed to net zero targets and have full control of the running of the estate to easily affect change. Additionally, the units are themselves starting from a good position being newly built to a high specification in respect to energy efficiency. As opposed to housing stock that is older and is not managed centrally by a large landowner/property investment company.

Additionally, where the residential properties are owned by investment funds there may also be a necessity to ensure they are meeting certain sustainability key performance indicators either in respect of a sustainability linked loans or in respect of compliance with the EU Taxonomy for sustainable economic activities for funds operating within the EU. (This will be applicable to investment funds that while having investments in the UK, also market their funds and/or have properties within the EU as well.)

CHANGING POLICY LANDSCAPE

In September, Rishi Sunak announced that two net zero policies for residential properties were being shelved:

- The minimum energy efficiency standards for residential properties were not to be tightened from the existing requirement to have an EPC rating of "E" or more.
- Relaxation of the 2035 deadline for the phase out of gas boilers.

This may mean there is less incentive for residential property owners to adopt legal provisions such as green lease provisions. However, beyond the UK's targets for net zero, most large organisations have already committed to sustainability targets and so they may continue to implement sustainable practices (supported by legal provisions in their property documents) to complement that work. For example, for affordable housing providers, there is the Sustainability for Housing ESG Reporting Standard ("SRS"), which requires detailed disclosures on member registered provider's activities. Please see further details below on a recent update to the SRS.

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Case Study — Sustainability for housing

Within the social housing sector, the Sustainability for Housing ESG Sustainability Reporting Standard ("SRS") 2.0 was published on 3 October 2023. The SRS has been adopted by more than 100 housing providers as well as 36 funders with more than £1trn of assets under management. The standard focuses on the following within ESG and these have been linked to the UN's sustainable development goals:

Environmental

- Climate change
- Ecology
- Resource management.

Social

- Affordability and security
- Building safety and quality
- Resident voice
- Resident support
- Placemaking.

Governance

- Structure and governance
- Board and trustees
- Staff wellbeing
- Supply chain management.

For further details see the press release and links to the SRS.

The aspects that the SRS focuses on often will be supported by certain legal practices, such as:

- **Environmental** – including provisions in leases to prevent works which could reduce the energy efficiency of a property (and thereby impact the EPC rating).
- **Social** – navigating the complex body of building safety legislation that is in the process of being implemented following the enactment of the Building Safety Act 2022. Additionally, advice on the drafting of short term leases/licences for placemaking initiatives, which allow for the innovative use of space, while still protecting the estate owner from damage caused by licensees or obtaining a vacant site at the relevant time (where further development is planned).
- **Governance** – robust corporate administration, which may require the amendment of legal constitutions of entities as well as possibly adopting new procedures or negotiating specific key performance indicators or other contractual provisions in lending documentation or supply contracts to meet environmental targets (such as reducing Scope 3 Emissions – those indirectly associated with the target company e.g. via transportation and the supply chain).

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