

# Hestia Net Zero Strategy



December 2022



## Welcome

Hestia is the Residential platform of Federated Hermes and aligns with our absolute conviction in the responsibility we hold to reduce the negative impact that the Real Estate has on the environment. Last year, we set out our ambition for our Commercial Real Estate portfolio to reach net zero by 2035 and here we present our approach for our Residential Real Estate. We have the same strong ambitions but with different challenges and opportunities. I am excited by the difference we can make in our approach to construction, minimising the carbon output in our developments as well in operation of the finished buildings, whilst also taking into account the insurance, health and safety and design considerations. The decarbonisation of our buildings is embedded in all of our processes and all of the decisions we make.

As we continue on our journey to net zero, our commitment remains strong.



**Chris Taylor**

CEO of Real Estate &  
Head of Private Markets

## Overview

As an emerging leader in the residential sector, Hestia currently has around £106m under management with and additional £460m under construction at various phases (as at 30th September 2022). We recognise both the responsibility and opportunity that provides in reducing the carbon emissions both in development and in the operating assets.

This document outlines our approach to achieving net zero on a whole life basis, taking into account both the embodied carbon that is produced in construction and fit out works, as well as the operational carbon produced in the lifetime of the building.

### Our approach to sustainability

Federated Hermes Limited (FHL) has signed up to the Net Zero Asset Managers initiative. The initiative represents a commitment from all signatories to work with their clients to reach net zero emissions alignment across their portfolios by 2050 or sooner and set interim 2030 emissions reduction targets.

This has been driven by the growing realisation that climate change is a global issue likely to impact long-term environmental, social and economic stability. Further to this, due to increasing legislation and the importance of managing climate risks and creating income resilience, all asset managers will be required to further integrate climate resilience considerations into their investment process. Federated Hermes Limited has long been a leader in this space. Our Real Estate Net Zero Pathway published in November 2021<sup>1</sup> sets out our high-level pathway for the commercial UK managed assets. This strategy provides further detail on how we intend to meet this goal.

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### Our commitment

We have set our proposed pathway to achieve net zero in our residential portfolio in the UK by 2030, with the focus on delivery against four specific pillars of activity. These are aligned with our equivalent net zero strategy for commercial managed assets.

### Investment boundary

Our roadmap to net zero has a target date of 2035. Alongside this roadmap, we have a long-term strategic plan to manage emerging risks and opportunities.

Our pathway focus is the Hestia residential portfolio in the UK which currently comprises two operational assets and a development pipeline of 7 projects. All new operational assets or developments are intended to come into the scope of this strategy.

Other residential property outside of the Hestia portfolio such as apartments within mixed-use assets will be aligned with the strategy to the extent possible considering long leases, technical constraints and potential conflicts with other regulation.

### Our carbon scope

This pathway covers carbon and other greenhouse gas (GHG) emissions from the development, construction and operation of our residential real estate assets. It considers both embodied carbon from new developments, major refurbishments and operational carbon. The pathway uses the RICS Whole Life Carbon (WLC) assessment methodology on a whole building basis.

Corporate emissions are excluded from the scope of this strategy.

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<sup>1</sup> Real Estate Net Zero Pathway: <https://www.hermes-investment.com/uploads/2022/02/14111363f613035ef2b0c9a4a98307e9/0011783-fh-real-estate-net-zero-pathway-2021.pdf>

## The four pillars of our pathway



### 1. Decarbonisation

**Avoid the use of fossil fuels, increase energy efficiency, use renewable energy and reduce embodied carbon in our new developments and major refurbishments. This should support improvements to local infrastructure and emphasise best-practice innovation.**

- **Decarbonising heating:** all new assets will be fossil fuel free and any acquisitions with fossil fuel based systems will be transitioned away from fossil fuels at the early possible intervention point.
- **Embodied carbon:** We will undertake embodied carbon assessments of new developments at an early stage including modelling of different construction systems to identify largest contributors to whole-life emissions and consider alternatives. The assessment will calculate both the upfront carbon (A1-A5) and whole-life embodied carbon (A1-A5, B1-B5 and C1-C4). An internal review of the application of embodied carbon assessments for medium to high-rise apartment schemes with ground floor commercial uses, including assessment for a number of projects in our development pipeline, suggests that there is currently a wide range of outcomes. This suggests the need for a greater evidence base in order to commit to the challenging absolute reduction targets proposed by LETI including a 2030 design stage upfront carbon target of  $<500\text{kgCO}_2/\text{m}^2$ , compared with a current 'business as usual' baseline of  $1,000\text{kgCO}_2/\text{m}^2$ . We will, however, commit to the following embodied carbon targets for new developments which will be reviewed and updated as more evidence is obtained:

#### 2025 – '25/25/25'

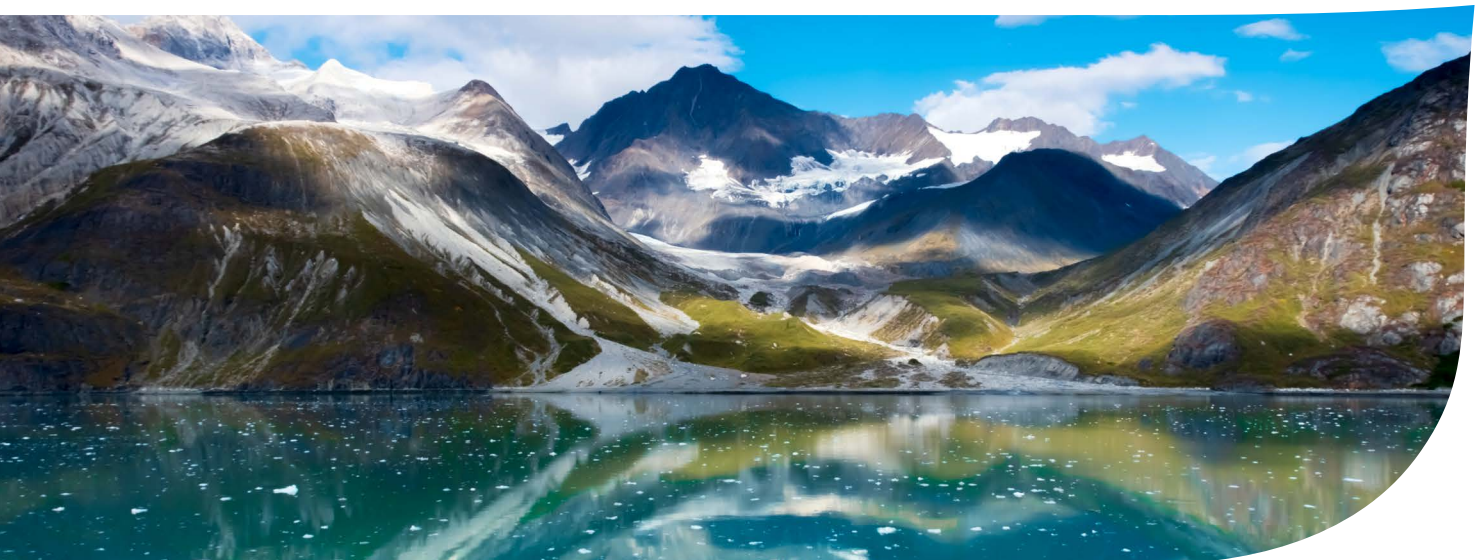
- All new residential developments and refurbishments to include the following design stage targets from 2025 onwards:
  - Upfront embodied carbon<sup>2</sup> excluding sequestration reduced by 25% against baseline ( $<750\text{kgCO}_2/\text{m}^2$  GIA)
- 25% of building materials from re-used or carbon negative sources
- 25% of building materials re-usable at end-of-life

#### 2030 – Whole Life Net Zero Carbon

- As-built upfront embodied carbon  $<600\text{kgCO}_2/\text{m}^2$  GIA taken as an average across all developments and major refurbishments completed in the 12 months before end of 2030.
- 33% of materials from re-used or carbon negative sources
- 50% of materials re-usable by 2030
- **On-site generation:** we will maximise the use of available roof area for solar generation within the portfolio both for existing assets and within development projects.
- **Green tariffs:** procurement through 100% renewables backed by zero carbon electricity has been mandated within our property management agreements (PMA) and is in effect for all of the electricity we purchase for landlord areas. Green tariff energy supplies will be setup for new properties which tenants will have the option to retain.

**33%** of materials from re-used or carbon negative sources

**50%** of materials re-usable by 2030



<sup>2</sup> Upfront embodied carbon includes building life cycle stages A1-A5 and includes substructure, superstructure, MEP, façade & internal finishes. Sequestration, FF&E and works external to the building footprint are excluded.



## 2. Deliver energy efficiency

**Reduce average EUI of portfolio to 60kWh/m<sup>2</sup>/year by 2030. New developments to be designed to achieve total energy use of 35kWh/m<sup>2</sup>/year from 2025.**

The two operational assets currently in the portfolio are both fully electrified and were built to high standards of energy efficiency.

Their metered energy consumption is significantly below the RIBA 'business as usual' benchmark of 120kWh/m<sup>2</sup>/year.

A detailed research project involving building physics modelling was undertaken using the base dimensions and specifications of these assets to explore alternative design options and determine how future schemes could be optimised to achieve the lowest possible energy use.

The 2030 energy targets will be achieved through the following:

- A 'fabric first' approach, limiting the need for space heating and cooling through measures including; enhanced U-values, window g-values and air-tightness compared with Part L requirements; and external solar shading
- All electric heating with ASHP for domestic hot water
- Mechanical ventilation with heat recovery
- 100% LED lighting
- Highest efficiency white goods
- Roof-mounted solar PV



## 3. Stakeholder engagement

**Work with occupiers, suppliers and other stakeholders to successful transition to net zero.**

### Operational carbon

We will continue to work with our design teams to optimise the operational energy performance of new development as described above, and our operational teams will continually investigate and implement any further opportunities for energy reduction within our existing assets, through the annual business plan process.

We will incorporate smart home devices within new dwellings which provide features and data that enable better decision making and automated optimisation of home energy consumption and associated cost.

This will help operational teams and occupiers navigate the inherent complexity when combining new low-carbon technologies such as embedded generation, energy storage, demand-side response and EV charging.

### Embodied carbon

The achievement of our embodied carbon targets will require us to work with our supply chain on the following:

- Work with design teams during the detailed design process to explore opportunities to reduce embodied carbon including reductions in material volumes and substitution of most carbon intensive materials.
- Source Environmental Product Declarations (EPD) or carbon footprint data from key suppliers for use in detailed design and as-built embodied carbon assessments.
- Make provision of EPDs or verified carbon footprint data a requirement on key suppliers and use as part of supplier procurement process.
- Work with supply-chain, and particularly Modern Method of Construction (MMC) solution providers to review ease of disassembly and material re-use as well as construction waste minimisation.



## 4. Utilise offset opportunity

**Use credible science based carbon-removal methodologies for residual carbon utilising schemes, such as natural-capital solutions for carbon sequestration to address embodied carbon.**

**The strategy will utilise natural capital solutions to deliver credible off-setting solutions. Our offsetting and carbon removals will be reported in tCO<sub>2</sub>e.**

We will develop a sequestration strategy to create natural carbon sinks to absorb any residual carbon in the RE portfolio. The strategy will utilise natural capital solutions to deliver credible off-setting solutions. Our offsetting and carbon removals will be reported in tCO<sub>2</sub>e.

# Integrating NZC through the asset lifecycle

## 1. Acquisitions

Our net zero strategy will inform all stages of our investment decisions including asset acquisitions, developments, refurbishment, operation and disposal. This does not mean we will be screening for acquiring net zero buildings only. We will be properly assessing the future risks for assets we acquire, and will develop an approach to manage assets in a way that will result in alignment with our net zero programme. This will include carrying out acquisition due diligence in line with our net zero requirements. We will also seek to obtain building ESG performance data from our sellers as a part of our acquisition process.

## 2. New developments

We will work with our partners to align all new developments with the 'Federated Hermes. Real Estate Design Innovation Standards' that underpin the requirements of our net zero pathway. Our approach to net zero will be based on the energy hierarchy as defined by the UKGBC Net Zero Framework and aim to reduce both the embodied carbon and the operational carbon of our buildings to meet the targets described in section 5.2.

## 3. Operational performance

We recognise the importance of our operational teams collaborating with our residents to reduce energy demand in our buildings. This includes the collection and reporting of energy and emissions data for both landlord and tenant spaces through the adoption of the latest data collection technology to track progress towards our targets. Energy and carbon reduction opportunities will be identified through analysis of trend data and net zero carbon audits for high consuming assets.

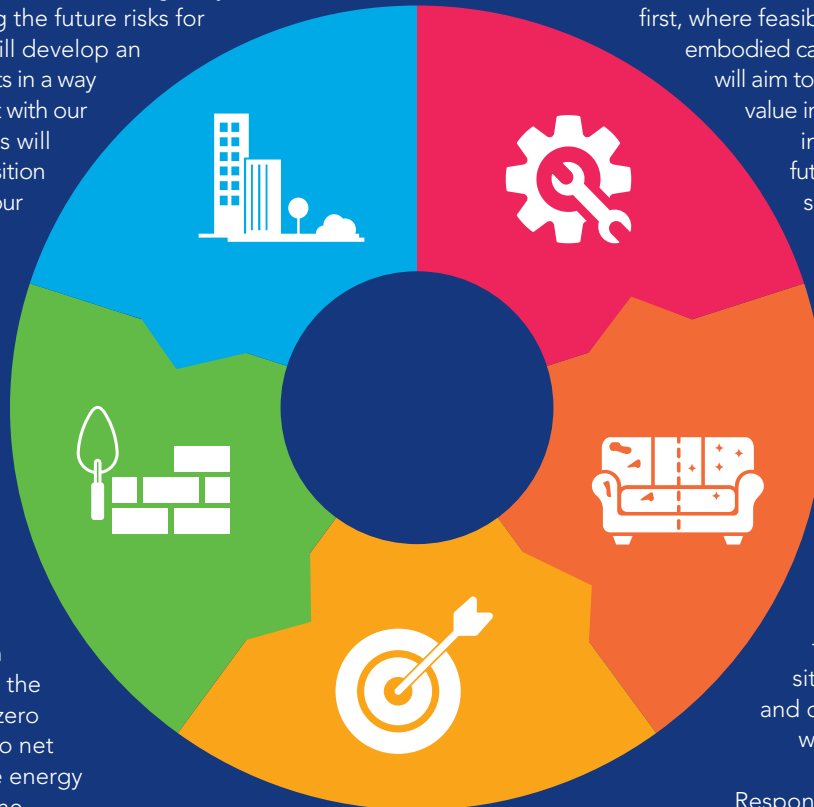
## 5. Disposals

We will consider a circular economy approach to prioritise refurbishment over demolition. Where demolition is required, we are going to implement an energy hierarchy. This hierarchy will ensure materials are used on-site and off-site first, where feasible, then recycled to reduce embodied carbon in our RE portfolio. We will aim to enhance and maintain asset value in our RE portfolio to increase income resilience for us and future potential buyers. We will share building performance data with potential buyers to responsibly dispose our assets.

## 4.

## Refurbishments and fit outs

Landlord refurbishments and tenant fit-outs play a vital role in removing fossil fuels and reducing the energy demand on our sites. To avoid costly retrofits and duplication of fit-out works, we will ensure – through our revised Federated Hermes Responsible Refurbishment Guide – to align all future refurbishments and retrofits to our net zero pathway requirements. Prior to each major site refurbishment, a feasibility study is to be carried out to establish if the building requires detailed redesign of fabric, plant or systems to become net zero aligned. For tenant fit-out, we will provide guidelines to ensure they are aligned with landlord systems and our pathway targets.



## Governance and communication

The NZC Framework includes a set of tools, processes and procedures that have been created to help govern the implementation of the net zero pathway in an efficient manner.

- **Working Group** – A Net Zero Working Group was established in 2020 to help draft the commitment and guide the implementation process. The working group consists of all key members from the Federated Hermes Real Estate team, ESG team, Investment teams, Board members, Fund representatives. The group meets on a monthly basis to help implement key steps in the Net Zero Pathway.
- **Tools** – The need for a specific set of tools to help deliver and embed the requirements of Net Zero was identified early on and this led to the development of tools across all asset life cycle stages including: ESG Acquisition Checklist, Design Innovation Standard, Responsible Property Management guide, Net Zero Passport, Net Zero Carbon Alignment Tool, Disposal Checklist. We conduct assets’ risk-tiering as for their net zero carbon potential and for high-risk assets we run net zero energy audits with data analysis and a site visit to develop a detailed and costed strategy for transitioning assets to net zero carbon.
- **Process and procedures** – A review of internal processes and procedures was carried out to ensure these align with the Net Zero implementation requirements. A FHL Net Zero Implementation document was developed in 2022 as a guidance document for investment and other internal teams to understand key process involved in the asset lifecycle.

- **Communication of data and KPIs** – We will maintain a net zero alignment report. The report is to be updated quarterly to show the number of assets that are net zero aligned and progress made against our wider net zero targets. This report will be supplied to the ESG team in advance of Net Zero Working Group meetings, to enable discussion and decision-making.

### Since our commitment in 2020, we have actively sought to partner with various external consultants to support us in our journey to Net Zero.

- **Reporting** – we will annually disclose our progress towards our net zero carbon pathway and explain the scope and implementation of this commitment relating to Hestia fund. The energy performance of our portfolio is to be publicly disclosed, where we have permission to do so, as a minimum at a portfolio level. Disclosures will be made at fund level, and ideally at a property level, and support efforts to develop consistent industry performance disclosure and benchmarks.
- **Delivery Partners** – Since our commitment in 2020, we have actively sought to partner with various external consultants to support us in our journey to Net Zero.
- **Training** – We see achieving Net Zero as a collective responsibility of all our employees within FHL. In order to enable that we are in the process of providing training to all internal key stakeholders through the BBP Real Estate ESG training for Asset Managers.

Figure 1 FHL NZC Framework across asset life-cycle

ACQUISITION	DEVELOPMENT	OPERATIONS	REFURBISHMENT & FIT-OUT	DISPOSAL
<ul style="list-style-type: none"> <li>● Follow ESG Acquisition checklist</li> </ul>	<ul style="list-style-type: none"> <li>● Follow Design Innovation Standard guide</li> </ul>	<ul style="list-style-type: none"> <li>● Work with Operational Teams to check assets via Net Zero Carbon Alignment tool</li> <li>● Undertake detailed NZ audits for high-risk assets</li> </ul>	<ul style="list-style-type: none"> <li>● Follow responsible Property Management refurbishment guide</li> </ul>	<ul style="list-style-type: none"> <li>● Undertake NZC assessment to understand value impact</li> <li>● Follow Disposal Checklist</li> </ul>



## Verification and certification

We will ensure that all our net zero data is verified by a third party annually. We have verified emissions to ISO 14064-3 since 2014 and will continue to do so.

Where a more specific net zero verification or certification scheme is available that clearly addresses value to stakeholders and appropriate transparency, we will revisit this approach. A breakdown of schemes to incorporate into the net zero programme is provided below in figure 2.

**Figure 2.** Verification schemes

	Scheme	Detail
<b>Verification</b>	ISO14064-3	All emissions continue to be verified to ISO14064-3 annually so as to confirm that the data and reporting system is correct.
<b>Validation</b>	1. Carbon Intelligence DIA review 2. Third party modelling	1.Data is validated on a quarterly basis by Carbon Intelligence Data Integrity Analysts. This includes all data reported to us and used for decision-making. 2. Third party modelling of all assets in scope and benchmark energy and carbon intensities against CRREM and national frameworks pathways.
<b>Certification</b>	Green Building certifications	New and existing developments will continue to be certified under building sustainability certificates including DfP, NABERS UK, BREEAM in use, etc., as appropriate.
<b>Reporting</b>	GRESB	Net zero and CRREM risk reporting to investors via GRESB.
<b>Reporting</b>	TCFD	FHL is committed to publish TCFD-aligned climate-related disclosures.
<b>Commitment</b>	UN Sustainable Development Goals (UN SDGs)	FHL aligns its activities with UN SDGs
<b>Commitment</b>	UN Principles for Responsible Investment (PRI)	FHL is a signatory to PRI since April 2006 and committed to responsible investing.
<b>Commitment</b>	BBP Climate Commitment	FHL NZ pathway aligns with the BBP Climate Change Commitment.
<b>Commitment</b>	Net Zero Asset Managers initiative	FHL commits to work with its clients to reach net zero emissions alignment across our portfolios by 2050 or sooner and set interim 2030 emissions reduction targets.
<b>Commitment</b>	World Green Building Council	The WGBC has a Net Zero Buildings Commitment, which this document aligns with, and commitment is recommended.

Source: Federated Hermes Limited, as of November 2022.

<sup>10</sup> Agreed, non-structural incentives which will not be binding to future owners and avoid a penalty to valuations.



## Appendix: Glossary and definitions

### BBP Climate Commitment

acknowledges the transformation that is required across the real estate sector to deliver net zero buildings by 2050. The commitment signatories hope that their leadership provides an important catalyst for change within the sector and encourages other property owners to follow suit. For more information, see: <https://www.betterbuildingspartnership.co.uk/member-climate-changecommitment>

### CRREM (Carbon Risk Real Estate Monitor)

The EU-funded tool primarily for the use of asset managers and investors, to identify the operational carbon stranding risk of buildings. A 'stranded asset' is defined by CRREM as a property that will not meet future carbon and energy efficiency standards and market expectations, and might be increasingly exposed to the risk of early economic obsolescence. CRREM sets the boundaries for the term 'stranded'.

### Circular economy

A systems solution framework that tackles global challenges like climate change, biodiversity loss, waste, and pollution. It is based on three principles, driven by design: eliminate waste and pollution, circulate products and materials (at their highest value), and regenerate nature. It is underpinned by a transition to renewable energy and materials.

For more information, see: <https://ellenmacarthurfoundation.org>

### EUI

Energy Use Intensity (EUI) expresses buildings energy consumption as a function of its size or other characteristic. In our pathway it is expressed as kWh per square metre per year. The measurement of floor area can be expressed in terms of Net Lettable Area (NLA) or Gross Internal Area (GIA).

### GHG Protocol

The Greenhouse Gas (GHG) Protocol is the internationally recognised accounting standard for GHG emissions

**ISO 14064-3** **ISO 14064-3** is an international standard for verification of GHG emissions in line with the GHG Protocol GHG accounting standard. The process of verifying emissions to ISO14064-3 checks that the data presented is correct, evidence-based and in alignment with the reporting guidance.

### TCFD

The Financial Stability Board created the Task Force on Climate-related Financial Disclosures (TCFD) to improve and increase reporting of climate-related financial information.

### The UKGBC EUI Pathway

To prioritise energy efficiency the UKGBC targets represent more stretching requirements for commercial offices claiming net zero in operation and set out a trajectory of tightening energy performance requirements over the next fifteen years.

The UK Green Building Council (UKGBC) framework has been developed by an industry task group of businesses, trade associations and non-profit organisations, undertaken in a spirit of collaboration and consensus-building. It provides guidance on the definition of net zero carbon buildings – both homes and non-domestic – and a way to demonstrate how a building has achieved net zero-carbon status. It focuses on carbon impacts that can be readily measured and mitigated today – operational energy and embodied impacts of construction. For more information, see: <https://www.ukgbc.org/wp-content/uploads/2017/09/UK-GBC-Task-Group-Report-Delivering-Building-Performance.pdf>

### LETI Climate Emergency Design Guide

The Low Energy Transformation Initiative (LETI) Climate Emergency Design Guide covers five key areas: operational energy; embodied carbon; the future of heat; demand response; and data disclosure. The guide was developed by over 100 LETI volunteers over a period of 12 months. For more information, see: <https://www.leti.london/cedg>

### LETI Pioneer Projects

A LETI Pioneer project will seek to achieve the KPI targets set out in the Climate Emergency Design guide. The LETI guide outlines the need for all new buildings to be Net Zero Carbon by 2030 and to get there 10% of all projects will have to be aligned with the LETI Design Guide. These are called as 'LETI Pioneer projects.'

### Re-usable material

A material that is able to be used again for its original intended purpose without significant modification. Small adjustments and cleaning of the component or product may be necessary to prepare for the next use.

### RIBA Climate Challenge

RIBA has developed the 2030 Climate Challenge to help architects meet net zero (or better) whole life carbon for new and retrofitted buildings by 2030. For more information, see: <https://www.architecture.com/-/media/files/Climate-action/RIBA-2030-Climate-Challenge.pdf>

**RICS professional statement** on whole life carbon The Royal Institution of Chartered Surveyors (RICS) Professional Statement on Whole Life Carbon (2017) is the standard for assessing both whole life carbon (Stages A-C) and embodied carbon (Stage A). For more information, see: <https://www.rics.org/globalassets/rics-website/media/news/whole-life-carbon-assessment-for-the-built-environment-november-2017.pdf>

### WGBC Net Zero Buildings Commitment

The Net Zero Carbon Buildings Commitment (the Commitment) challenges companies, cities, states and regions to reach net zero operating emissions in their portfolios by 2030, and to advocate for all buildings to be net zero in operation by 2050. By setting ambitious 'absolute' targets, the World Green Building Council (WGBC) Commitment aims to maximise the chances of limiting global warming to below 2°C, and ideally below 1.5°C, by drastically reducing operating emissions from buildings. The Commitment provides a framework for organisations to develop globally ambitious yet locally relevant, flexible and universally viable solutions for their portfolio to both reduce energy demand and achieve net zero carbon emissions. For more information, see: <https://www.worldgbc.org/thecommitment>

### Definition – what is net zero?

There is often confusion around what is meant by net zero due to the lack of a commonly agreed upon definition. Moreover, the term 'net zero' is commonly confused or conflated with terms like 'carbon neutral', 'zero carbon' and 'carbon negative'. For clarity, in the context of our pathway we define net zero as 'reducing company and value chain greenhouse gas emissions in line with limiting warming to 1.5 degrees Celsius, and to balance any remaining emissions by enhancing carbon sinks which remove carbon dioxide from the atmosphere.' For real estate this means: 'the carbon emissions emitted as a result of all activities associated with the development, ownership and servicing of a building are zero or negative.'

## Federated Hermes

Federated Hermes is a global leader in active, responsible investing.

Guided by our conviction that responsible investing is the best way to create long-term wealth, we provide specialised capabilities across equity, fixed income and private markets, multi-asset and liquidity management strategies, and world-leading stewardship.

Our goals are to help people invest and retire better, to help clients achieve better risk-adjusted returns, and to contribute to positive outcomes that benefit the wider world.

All activities previously carried out by Hermes Investment Management are now undertaken by Federated Hermes Limited (or one of its subsidiaries). We still offer the same distinct investment propositions and pioneering responsible investment and stewardship services for which we are renowned – in addition to important strategies from the entire group.

## Our investment and stewardship capabilities:

- **Active equities:** global and regional
- **Fixed income:** across regions, sectors and the yield curve
- **Liquidity:** solutions driven by four decades of experience
- **Private markets:** real estate, infrastructure, private equity and debt
- **Stewardship:** corporate engagement, proxy voting, policy advocacy

For more information, visit [www.hermes-investment.com](http://www.hermes-investment.com) or connect with us on social media:



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