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Business Markets

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Our weekly series on the best picks for ethical investing

Green buildings set to raise the roof

With everyone focused on transport and agriculture, buildings tend to sit under the radar in terms of emissions. In fact, buildings and construction account for almost 40 per cent of CO_2 emissions related to energy use, according to the UN Environment Programme.

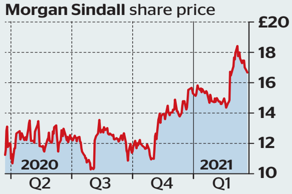
That makes the sector a target for governments as they scramble to meet commitments to limit global warming to well below 2C, preferably 1.5C, compared with pre-industrial levels — which are legally binding under the Paris climate agreement.

Regulation is going in only one direction. The government said in January that by 2025 new housing must produce 75 per cent to 80 per cent fewer carbon emissions than allowed at present and no new homes should be built with fossil fuel heating, such as a natural gas boiler. Similar rules for non-domestic buildings are expected to follow.

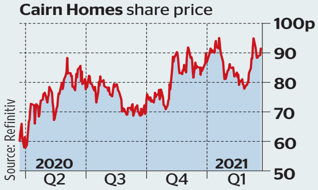
Money is now flooding into the green building sector, which is expected to be one of the biggest global investment opportunities of the next decade, according to the International Finance Corporation.

Two investment opportunities

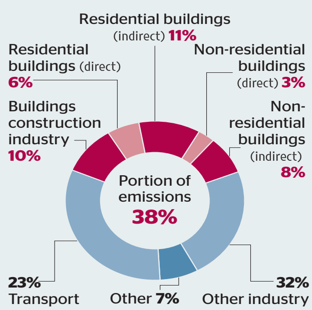
Morgan Sindall share price



Cairn Homes share price



Global share of CO2 emissions related to energy use



Source: United Nations Environment Programme

MORGAN SINDALL

There are some companies that have been on top of environmental, social and governance issues for a long time and you can almost sense their relief that investors are starting to take note.

Morgan Sindall has cut its emissions by almost two thirds since 2010 while expanding the business by a third, and it aims to cut emissions by another 60 per cent by 2030. The London-listed building contractor reports its progress to CDP, an international non-profit organisation that many of the world's largest companies use to assess their climate impact. CDP is rigorous, so it is significant that Morgan Sindall was awarded an A rating for its actions to tackle climate change last year.

For a building company, Morgan Sindall did not do too badly in 2020. Pre-tax profits fell by 30 per cent but are expected to bounce back to 2019 levels this year. The company took money from the government's job retention scheme, but paid it back by the end of the year and made up the difference for non-senior employees who took voluntary pay cuts.

A £790 million company, it works on a mixture of building roads, schools, hospitals and railways; maintenance and repairs for public sector housing and office fit-outs; and urban regeneration programmes. While it is exposed to the commercial property market via its fit-out business, that could benefit from a shift in working practices prompted by the pandemic as companies are forced to adapt office space. Elsewhere, it is in a good position to see at least some of the £100 billion the government has promised to spend on infrastructure.

With more than £100 million of cash on its books, Morgan Sindall's strong balance sheet will help it to win work this year as clients choose their contractors based on which will survive long enough to finish a job.

The shares have rallied by more than 50 per cent over the past year to £16.70 yesterday, but look like they have further to go based solely on what the management team, which is known to be conservative, say they will achieve this year. Add in the green building revolution and a healthy dividend of 4 per cent and it's a strong "buy".

ADVICE Buy
WHY A solid investment in a well-run company
IMPACT It's setting the tone for the construction industry

CAIRN HOMES

Another way to invest in more energy-efficient buildings is to look across the Irish Sea. European building regulations mean that new-builds in Ireland are already meeting much more stringent energy efficiency standards.

Cairn Homes, which is listed in London and Dublin, is one of the two big housebuilders in Ireland. As well as building homes with the required A-rating for energy efficiency, it equips them with heat pumps rather than gas boilers and solar panels to provide zero-carbon heat and power.

Ireland had one of the strictest lockdowns in the world and builders lost about a quarter of the year to Covid-related restrictions playing havoc with their schedules. Cairn was not immune and its pre-tax profits sank by 75 per cent last year. Ronan Dunphy, a Dublin-based analyst at Investec, seems relatively unworried and is confident that growth outlined by management before the pandemic "has been delayed rather than fundamentally altered".

The worry is that Covid-19 has battered the economy so profoundly that demand for housing drops, but thus far it has remained relatively strong. Unemployment may have increased, but those affected were often in the lower-paid parts of the economy and were unlikely to be buying houses, anyway. Lockdowns may even have boosted demand as people stuck at home reconsider their living situations.

There was already a shortage of housing in Ireland (the Central Bank of Ireland estimates that about 34,000 homes need to be built each year simply to keep up with demand and only 20,000 were built in 2019) and that has been exacerbated by the shutdowns.

From an impact investing point of view, Cairn has an important part to play. The investment case is that it will benefit from demand-supply dynamics, which Mr Dunphy says probably will result in a 4 per cent increase in house prices this year.

Cairn has enough land for ten years' worth of building, but wants only a five-year landbank, so will not be investing in more land over the next few years. That means it will be generating plenty of cash. The company suspended its dividend and halted a share buyback programme last year. However, having forecast free cashflow of up to €400 million over the next three years, it is expected to restart the dividend at its half-year results and to lay out plans to return cash to shareholders.

The company's shares change hands for 93¾p, meaning that Cairn is worth about the same as its combined assets. That looks cheap compared with housebuilders in the UK, which trade at about 1.8 times their book value.

ADVICE Buy
WHY The housing market in Ireland has further to run
IMPACT Energy-efficient buildings will cut emissions for the long term