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ESG in real estate - how green is your castle?

ESG edition

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Institutional investors have been increasing their exposure to real estate, with target allocations recently crossing 10% according to a leading industry survey¹. But with more money flowing into real estate than ever before, the industry is coming under pressure to do more on the environmental, social and governance (ESG) front.

Unlike investments in stocks and bonds, real estate represents a tangible, physical ownership of land or property and as such fund managers can have more control over the E, S and G aspects of their investments. Undoubtedly the industry is starting to take sustainability factors more seriously. But with buildings accounting for 40 per cent of global primary energy consumption and 30 per cent of CO2 emissions², even small steps taken to improve ESG in the sector can have a disproportionately positive impact.

ESG has entered the building

Real estate has a big part to play in building a more sustainable world. Investors are now starting to demand clear and detailed sustainability strategies from real estate managers. At present, building standards, green certification schemes and environmental legislation vary from country to country and continent to continent, so the task of 'greening' a real estate portfolio can be both complex and confusing. The age, location and use of property will also dictate what options there are. There is no one-size-fits-all solution.

A raft of new benchmarks and standards is pushing the industry towards a greener outlook - chief amongst these is the Global Real Estate Sustainability Benchmark (GRESB), a benchmark which is used by about 60 pension funds and their fiduciaries, representing a total of more than \$7.5 trillion in assets under management. For many global mandates, the GRESB standard is now the minimum requirement needed for fund managers to even make the long list.



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These new benchmarks are giving investors the information to make better decisions, while advances in technology and building materials mean that external auditors will keep raising sustainability standards. All of which will keep real estate managers on their toes.

Green is the new gold

In future, environmental regulations are only likely to get stricter, which means that as real estate fund managers, we must pay more attention to the risks – and rewards – associated with the sustainability of our investments.

The good news is there are huge benefits for both owners and tenants in investing in more environmentally friendly and energy efficient properties. Green building design and construction methods are improving all the time, giving property managers greater choice for retrofitting existing assets or developing new sites that are environment-friendly, resource-efficient and provide a healthy environment for occupants.

An example from Germany

So what should investors look for in sustainable real estate? A recently developed logistics warehouse in Grossbeeren, south Berlin that is expected to obtain a gold certification from the German Sustainable Building Council (DGNB) – a standard that considers the environmental, social and economic impact of real estate throughout the lifecycle of the asset, through its construction, use and demolition - provides some examples.

Here are some of the key sustainable considerations of the Grossbeeren development:

- **Flexibility throughout lifecycle** - Real estate properties are likely to have multiple tenants throughout their life. Opting for a building design that gives maximum flexibility in the configuration of space helps maximise utility. The warehouse in Grossbeeren can be divided into six subunits and the office spaces can be resized and rearranged easily. The ceiling height is suitable for all typical warehouse usages including high-rack layouts. An additional mezzanine floor can be used for storage, social areas or extra office space.
- **Energy efficiency** - This is perhaps the key parameter for determining the sustainability of buildings and where regulation is clearest on the need to bring about a reduction in energy consumption and associated emissions. The exterior facade panels of the warehouse use superior insulation to achieve high R-values, a measure of the effectiveness of insulation. A high standard of wind and water tightness was designed into the building, which will cut energy consumption by increasing the effectiveness of insulation layers and reducing drafts, as well as improve the expected lifespan of the building.

- **Heating and cooling** - These systems consume a lot of energy and generate the lion's share of greenhouse gases, so mitigating measures are an essential feature of green building design. The warehouse's mezzanine has windows that open, which improves air quality and circulation, and external sun blinds, greatly reducing the need for air conditioning in summer. Natural gas-fired radiators with reflector shields are used, ensuring that as much heat as possible flows to where it is needed, rather than rising to the ceiling.
- **Lighting** - Intelligent LED lighting systems featuring daylight and movement sensors are in use inside and outside the warehouse, allowing lighting to be used only as needed rather than constantly on.
- **Water management** - Water is a scarce resource, and its efficient management is one of the hallmarks of sustainable real estate. However, water management involves more than installing automatic taps. Storm-water management will be an increasing focus as climate risks grow. The process for the warehouse in Berlin included analysing the soil beneath the construction site and building a soil-appropriate infiltration basin to collect rainwater and allow it to filter naturally into the ground, reducing the risk of flooding.

Benefits that are built to last

The benefits of incorporating sustainability criteria into real estate portfolios go far beyond the mitigation of climate risk. They include lower energy, water and operating costs, a more comfortable working environment and enhanced green credentials for investors and tenants.

ESG factors are also playing an increasingly significant role in how prospective employees view their employer. Many businesses are using their occupational space to showcase their ESG credentials in a bid to both attract and retain their workforce.

In addition, investing in sustainable assets also delivers better value preservation and liquidity over the lifetime of the asset. As environmental costs increase, inefficient assets will become less attractive to prospective tenants and buyers.

With greater investor scrutiny, stricter regulations and changing social attitudes all on the horizon, the long holding period of real estate assets means intelligent investment not only needs to be ESG compliant by today's standards but also to have an eye on the future.

Notes

1. <https://www.hodesweill.com/single-post/2017/10/13/Global-institutional-real-estate-allocations-pass-10-for-first-time>
2. <http://web.unep.org/10yfp/programmes/sustainable-buildings-and-construction-programme>

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