



Sustainability in Real Estate: Trends, Opportunities and Challenges

CMS' real estate and real estate finance teams recently hosted a panel discussion exploring some of the trends, opportunities and challenges facing the real estate sector in the environmental, social and governance (ESG) sphere. ESG factors are becoming increasingly important for our clients and we wanted to understand the drivers, the difficulties encountered by the industry and find out what the market is doing to embrace the opportunities.

As panel members, we welcomed **Josien Piek** - Head of EMEA at GRESB, **Edward Dixon** - Head of ESG at Aviva Investors Real Assets, **Tim Clare** - European Head of ESG at Anthesis and **David Hirst** - Executive Director, Chair of UBS Asset Management, Real Estate & Private Market's Sustainability Workgroup. Our audience largely comprised real estate investment, development and advisory professionals from across the sector.

We invited our guests to participate in a survey of which 68 attendees responded and we refer to those responses in this report.



SPEED READ

KEY TAKEAWAYS FROM OUR SURVEY

1. Awareness of ESG, in particular climate change related issues, has permeated the real estate industry and the majority of professionals see it as high priority or working its way up their corporate agenda.
2. GRESB is currently the most popular ESG benchmarking system for the real estate sector.
3. The urgency for climate change related action is acknowledged; however, there are several challenges to translating this understanding into action.
4. Lack of understanding, cost/impact on returns and short term thinking are perceived to be the biggest factors preventing prioritisation of ESG.
5. Time is ripe for government intervention

KEY TAKEAWAYS FROM OUR PANELLISTS

1. Forget the apparent complexity - develop an ESG strategy that works towards preparing your business for a future where ESG issues have increasing impact on the bottom line.
2. Boards are considering ESG from a risk point of view.
3. Advisory teams should be playing a bigger role in influencing clients to prepare and implement their ESG strategies.
4. GRESB is an investor lead initiative which currently hosts US\$4.5 trillion assets worth of data.
5. Investors that choose to ignore ESG “cost” now will pay in the future because the agenda will not go away, even if there is another financial crisis.
6. When considering ESG it is helpful to explore common frameworks, such as the 17 UN Sustainable Development Goals.
7. Tenant engagement in ESG is key.
8. Regardless of the size of the asset, best practice is to bring all stakeholders together to forecast how demands on and of a building are going to change during its lifetime and design accordingly.



SURVEY RESULTS

Utmost urgency:

We asked our guests: ***How urgent do you think the sustainability agenda is?***

53% of our respondents rated it 10/10 (i.e. utmost urgency).

Climate change, in particular, is rarely out of the press. As Edward put it simply: *“the world is changing quickly and...it’s about being ready for that change”*. Sustainability isn’t just about doing good - it is about future proofing your businesses and our wider economy. This means having a long-term focus on a development and its impact and how resilient a building will be in a changing world.

Tim identified that risk (rather than investor preferences) has recently driven ESG up the board agenda. The panel acknowledged that 2019 has been a big year for climate change. However, the current interest in climate change has come on a wave of a wider focus around sustainability issues over the last few years (for example, the role of plastics reduction in retail). The real estate industry appears to have woken up to the fact that it needs to play a role in combatting climate change, but is perhaps unsure about which direction it is heading.

Josien confirmed that GRESB (celebrating its 10th anniversary) holds actual performance data for more than US\$4.5 trillion assets, allowing for real comparisons on performance levels (in energy, greenhouse gas emissions, water and waste) between assets

“S” and “G”:

Our discussion was mainly focused around the environmental impact of buildings. However, the “social” and “governance” focus is equally important. The environmental benefits (or otherwise) of projects are difficult to measure, but at least there are clear targets to strive for (i.e. net zero carbon by 2050).

However, on the social side, things are much more fluid. David said that UBS has carried out a full analysis of the social impact of one of its shopping centres as a pilot project. The pilot measured the value being created by on-site property management and occupiers through its social engagements, such as local employment, apprenticeships and rehabilitation of offenders. David confirmed that these assessments would be rolled out to other assets it owns manages.

The importance of governance really comes down to what structures are in place to ensure that when decisions are made, the decision maker is properly informed the ESG impact of that decision. Green leases play an important role for governance. However, the panellists commented how tenants' solicitors often push back on the standard green lease clauses. Furthermore, the people on the ground in tenant occupied units, who play an important role in data collection, are often not interested in engaging in assisting landlords in their green credentials.

Our panellists noted that inequality is rising and life expectancy in the UK is falling. It is important for business to be prepared for those changes in society. In addition, the way that we live and work will change over the years and this is something which needs to be factored into developments.

Measure for measure:

From our survey, where an ESG benchmark system was used, this was almost always GRESB. However, other benchmarks identified by our respondents were Wellbeing, greenhouse gas emission levels, Passivhaus for building energy efficiency, EPRA, FTSE4Good and BREEAM.

Our respondents also identified the following challenges for the real estate industry in engaging with ESG: data collection, lack of understanding, availability of information, measuring impact in a meaningful way, and lack of resources.

David noted a marked change in the last five years, with the industry embedding itself in ESG principles. He said that this has mainly been driven by GRESB, leading to a common understanding of how to design and run a real estate sustainability programme with resulting improvements.

Josien commented on the importance of having a level playing field with peer comparisons (and aggregated comparables): this drives actual improvements and transparency is key. GRESB is an investor led facility and therefore focuses on the information from an investor's point of view. TCFD (Task Force on Climate -related Financial Disclosure), which is a voluntary disclosure scheme, also has transparency at its heart and this was also recognised as an important tool.

However, the transition between looking at how a portfolio looks now, to how it should look for a future-facing business requires further analysis. It requires a proper analysis of global environmental risks for the future. David commented how investors want to know how their investments are impacting on the 17 UN Sustainable Development Goals and therefore if this is something that can be measured, this could really deliver value to investors. However, the positive impact of the 17 UN Sustainable Development Goals is not the only way of looking at these. You can also assess your negative impact against these goals.

Completing a GRESB survey is an involved project and in order to do this a business really needs to understand its assets. Although the panelists responded positively to GRESB, they acknowledged that it wasn't flawless. In particular, without "smart" or "real time" data collection facilities, data is difficult to obtain; much of the data required for the GRESB survey also relies on tenant co-operation (which is not always forthcoming) - that improving your GRESB score would not necessarily result in better performing buildings; and improving a benchmarking score is not the same as having ESG strategy driven goals. GRESB is, after all, just a platform and it is for people to use it, but the areas that GRESB collect data on can drive positive change where it is used properly (and not just used as a tick box exercise).

Josien stressed the importance that GRESB is not so interested in the top performers, but is interested in ensuring that the wider market understands the importance of transparency and gets on board.

Bring on the law:

Perhaps the most surprising statistic from our survey: 86% of our respondents thought we needed more government intervention in the sustainability arena.

The real estate industry, like many others, tends to be naturally resistant to regulation, so this survey result suggests a marked change in direction in the context of climate change. What are the reasons behind this? This may be because the industry through its various voluntary and self-policing initiatives has done as much

as it can. Businesses are clearly nervous to take steps for fear of risking their financial returns and becoming less competitive and would therefore welcome government intervention to create a level playing field.

One area where regulation could really have an impact is around the retrofitting of buildings to ensure that stock is kept fit.

Positive horizons:

Our survey respondents identified a few opportunities for the real estate sector: positive brand identity and unlocking new financing potential through green and sustainable finance. However, beyond the urgency of dealing with climate change, the positive horizons were, perhaps, a little foggy. This indicates that the financial benefits of pursuing an ESG agenda, particularly at the smaller asset level, are yet to be clearly articulated for many.

Tim noted that customers increasingly carry out sustainability reviews on acquisitions and therefore the real estate industry is looking at the sustainability arena in investment decisions.

All the panelists felt that the market had reached a stage where ESG factors were now sufficiently entrenched that these would not be neglected in the event of a future economic downturn.

Conclusion

The real estate sector cannot ignore the significance of environmental, social and governance factors, whatever the size of the portfolio or development proposal. It has built up great momentum over the last few years and if future proofing your business, this is unlikely to go away. There is still much to be shared in this area and this is something we look forward to picking up at our next event where we will aim to address some of the opportunities that the real estate industry should grasp.

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The planet is changing really, really quickly and as real estate professionals, we need to be on top of what that will mean for our buildings, our portfolios and our businesses.

*Edward Dixon, Head of ESG -
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