Quantifying sustainability

Investors and managers are taking a more structured approach to ESG, but there is more progress to be made, say experts from GRESB, Kempen and Altera Vastgoed. By Stuart Watson

The real estate industry has made great strides in sustainability over the past decade yet remains one of the largest emitters of carbon and users of energy. The latest GRESB survey quantifies how the industry is responding to environmental, social and governance issues. GRESB director of real estate Roxana Isaiu and climate change specialist Erik Landry discuss the state of sustainability and some of the GRESB 2020 findings with Peter Bretveld, senior portfolio manager at Kempen, and Rudy Verstappen, ESG research manager at Altera Vastgoed.

> *"More capital is moving into sustainable real estate projects"*
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> **ROXANA ISAIU**
> **GRESB**

ESG approach improving

Roxana Isaiu: We're in GRESB's second decade now, so let's first look back over the past decade in real estate sustainability. For us, one of the most notable evolutions that we've seen is a shift toward a more structured and target-based engagement from investors and their managers.

Peter Bretveld: What we've also seen in that time is that managers are now much more capable of measuring the impact they have. They are installing measuring equipment in all their assets and this, alongside measures such as LED lighting, has significantly improved their reduction in energy consumption. However, this is still not sufficient. We're not making enough progress toward the 1.5-degree Celsius pathway agreed in Paris, so the likelihood of negative impacts from climate change increases significantly.

Rudy Verstappen: Those negative impacts of climate change have become clearer in recent years, and this has contributed to a growing sense of urgency in the real estate industry. In the earlier stages, sustainability was something nice to have, but now regulators, investors and tenants see that climate change is actually happening. What is positive for real estate is that you can really see what the effects are and make measurable adjustments. By giving us a common language to discuss these issues, GRESB has helped to create more momentum for the sustainability agenda within and among organizations.

Erik Landry: As a consequence of this more structured approach, we're seeing more target-setting among GRESB respondents. Overall, more than 85 percent of eligible GRESB real estate participants set long-term performance targets. There is some variance by region: 96 percent in Oceania, 92 percent in Asia, 88 percent in Europe, and 79 percent in the Americas. And overall, one-fourth of eligible participants set science-based performance targets for themselves.

PB: We're happy that a high percentage of managers are setting targets and it's important to say how you measure them and how you compare them.

However, the Science Based Targets initiative is quite general. Perhaps there are better solutions which would take a more sectoral approach and regional approach?

RV: What I see in the results of the SBTi, is that it's much easier for a real estate investor to report Scope 1 [direct emissions] and Scope 2 [indirect emissions from the electricity used by an organization], but it's more difficult to report on and control Scope 3 emissions [other indirect emissions]. As an investor, we can actively influence the first two and become more sustainable.

Scope 3 is more difficult because we have to engage our tenants and try to make them behave more sustainably. We can have a well-insulated building with solar panels, but if our tenant has the windows open and the heating on, the overall picture suffers. We engage with our tenants on energy use, but we can't force them to not use that much energy. So, I imagine some managers are reluctant to set very concrete targets on that issue. We actively steer on increased environmental awareness by engaging with our tenants by providing a sustainability starter kit, the inclusion of green lease sections in rental agreements and by supporting local sustainability initiatives.

Tenant engagement

RI: I see tenant engagement as an area of improvement over the next few years. On the bright side, 95 percent of the eligible entities which report their data to GRESB have a tenant engagement program that includes ESG-specific issues. That sounds good, but you do wonder what the 5 percent not interacting with tenants are doing! Furthermore, only 78 percent have run a tenant satisfaction survey in the past three years, and even fewer managers do this in a quantifiable way. Looking globally, Australia is leading the way in this.

PB: There are more things managers can do here, to sit together with the tenants and explain when their usage is high and boost their understanding and knowledge. Another way to look at it is that the landlord is responsible for providing the tenant with a comfortable environment to their specifications and therefore is also responsible for managing the emissions from that required amount of space, heat and light. It's all the asset owner's responsibility in that sense.

Measuring impact

RI: A question we get often is about the measurable impact of sustainability initiatives on actual real estate performance. And it's very difficult to separate proper ESG management from proper business management and proper operations management. Every time we're asked 'do companies that do better on ESG actually perform better from a financial standpoint?', it's often difficult to draw a direct causal line. However, companies that do well financially also do well from an ESG perspective and the other way around, because it's just a sign of good management and good business practice.

The path to net zero targets

More property owners have embarked on pathways in line with the ambitions of the Paris Agreement

GRESB survey data show real estate managers setting a range of targets which, if not necessarily putting them on a path to net zero emissions, will get them close to net zero status.

The Carbon Risk Real Estate Monitor, an EU Horizon 2020 project, of which GRESB is a founding consortium member, offers asset owners a methodology to set them on either a 2 degrees or 1.5-degree pathway. "By and large, the CRREM 1.5-degree pathway brings real estate quite close to net zero by 2050," says Erik Landry, GRESB climate change specialist. Around three out of every four eligible GRESB respondents set a greenhouse gas target, generally as an intensity-based target. Of those that set targets, "just under half set certificate-related targets, and just over 30 percent set renewable energy targets," he adds.

Rudy Verstappen, ESG research manager at Altera Vastgoed, says: "We've published our net zero carbon commitments quite recently. It's easy to say our operating portfolios must be net zero by 2050, but another thing to do it. The CRREM tool allows us to see at the asset level which renovations we have to do, and which expenses we have to make to ensure that we're still on target."

Talking to tenants

Are GRESB real estate participants doing enough?

95%

Share of performance component participants with a tenant engagement program in place

77%

Share of performance component participants that have undertaken tenant satisfaction surveys in the last three years

98%

Share of those that have undertaken a survey and that have then implemented a program to improve tenant satisfaction based on the outcomes of the survey

Source: GRESB

RV: It's the stable long-term sustainable returns which matter to investors, based on a solid strategy and the execution power in order to achieve these goals. Clear KPIs will measure the ongoing improvement of the long-term goal. We can see climate change risk growing over the coming decades and we have to act now. So, it's more about getting our risk management in order and making assets more resilient, which will lead to outperformance in the future.

EL: Resilience also incorporates elements of being able to take advantage of opportunities that arise. In the same vein that risk management can mitigate the downside posed by physical climate risks, there are a lot of opportunities that can increase upside potential. So, if you can invest in your building and do more than just improve the energy rating level, that could also lead to outperformance in the future. Balancing both risk management and building the capacity to take advantage of opportunities as they arise will be important for financing.

RI: More capital is moving into sustainable real estate projects, both on the private equity and the debt sides. We've seen double-digit growth in green bonds, for example. There's definitely much more to be done, but the signals are very encouraging. I'm not aware of investors that have rejected investments solely based on ESG criteria, but wondered if this does happen?

RV: A thorough ESG strategy and a five-star GRESB rating are good indicators for investors during the selection and monitoring process of their managers. In the longer term, I expect investors will become more structured in their approach and look at not just the number of stars, but also at carbon intensity per square meter in the portfolio.

Looking ahead

RI: If there are any positives for the future coming out of this current pandemic crisis, one is that it has forced everyone to think of real estate from the perspective of its users. It's almost as if we just found out that buildings are used by people and need to operate to benefit those people! So, in the future we will see a stronger focus on health and wellbeing and evaluating the performance of buildings from the perspective of their impact on tenants.

RV: The most material issues around real estate and ESG were traditionally focused on the environment, especially climate change. However, the social element has risen up the agenda, but that doesn't mean we row back on our environmental commitments. Also, looking ahead to the next decade, there will be a convergence of standards – reporting standards and performance standards. Right now there are many ways to report on ESG issues, but I think by the end of the decade there will be just one, as with accounting standards.

"It's easy to say operating portfolios must be net zero carbon by 2050, but another thing to do it"

RUDY VERSTAPPEN
Altera Vastgoed

PB: Real estate will be more people-centric and this will lead to a focus on both value and energy use, not so much by square meter, but by person. If you have an asset that's efficiently used, where a lot of people are making use of that asset seven days a week, 24-hours a day, then that asset is already much more efficient than one that's only operating from nine to five on workdays, for example. Measuring that at the person level makes more sense, but it's more complicated too. ■

Regulatory pressure ramps up in Europe

The EU's Sustainable Finance Disclosure Regulation comes into effect in March 2021. GRESB participants are already highly aligned with its 32 indicators, particularly on greenhouse gas emissions, energy performance and waste, but have improvements to make on diversity and inclusion.

GRESB alignment with SFDR

EU Sustainable Finance Disclosure Regulation			GRESB Fund Assessment Alignment		
Adverse sustainability indicator			**Performance measure**	***Alignment level**	**2020 GRESB participants reporting for this indicator**
Greenhouse gas emissions	1	Carbon emissions	Greenhouse gas emissions	2	93.73%
	2	Carbon footprint	Greenhouse gas emissions	2	93.73%
	3	Weighted average carbon intensity	Greenhouse gas emissions	2	93.73%
	4	Solid fossil fuel sector exposure		0	
Energy performance	5	Total energy consumption from non-renewable sources and share of non-renewable energy consumption	Energy consumption	2	93.73%
	6	Breakdown of energy consumption by type of non-renewable sources of energy	Energy consumption	3	93.73%
	7	Energy consumption intensity	Energy consumption	2	93.73%
	8	Energy consumption intensity per sector	Energy consumption	2	93.73%
Biodiversity	9	Biodiversity and ecosystem preservation practices	Risk assessments performed on standing investments portfolio"	3	36.53%
	10	Natural species and protected areas		0	
	11	Deforestation		0	
Water	12	Water emissions		0	
	13	Exposure to areas of high water stress		0	
	14	Untreated discharged waste water		0	
Waste	15	Hazardous waste ratio	Waste management	3	93.73%
	16	Non-recycled waste ratio	Waste management	3	93.73%
Social and employee matters	17	Implementation of fundamental ILO conventions	Policy on environmental issues	1	99.27%
	18	Gender pay gap	Inclusion and diversity	2	*Governance bodies:* 44.67% *Employees:* 56.47%
	19	Excessive CEO pay ratio		0	
	20	Board gender diversity		3	87.63%
Anti-corruption and anti-bribery	21	Anti-corruption and anti-bribery policies	Policies on governance issues	3	98.62%

*Table shows GRESB members' alignment with 21 of the 32 SFDR indicators. 0 indicates no alignment with SFDR indicator; Alignment level 1 denotes low alignment, with the indicator's objective/scope addressed; level 2 denotes moderate alignment, with the indicator's objective/scope and its underlying content addressed; level 3 denotes full alignment, with the indicator's objective/scope, underlying content and requirements/metrics all addressed

Source: GRESB