# Good for business

**15 March 2019**

**While quantifying environmental performance is not without its difficulties, real-estate managers and investors are increasingly interested in sustainability as part of a broader agenda**

---

Over the past ten years, the GRESB benchmark has developed into the one most widely applied for environmental, social and governance (ESG) factors in real-estate assets, with strong support from the sector and global reach.

In 2018, the benchmark covered 903 real-estate firms and funds valued at more than $3.5tr, and now almost 80 institutional investors, representing in excess of $18tr use GRESB as the main source of ESG data in due diligence and stewardship. During this time, real-estate investors have become more aware that ESG considerations make for good business practice, and started to track their ESG performance in a systematic way to shape future investment strategies.

Yet despite the progress that we?re seeing in the market, ESG factors remain difficult to price, and it is not always possible to find a linear cause?effect relationship between overall ESG performance and financial performance. There are several reasons for this. Not only do many factors influence the performance of an asset but, by definition, a good ESG programme encompasses a broad range of indicators, and touches, directly or indirectly, on all parts of the business.

Leading ESG programmes are based on risk assessments and detailed resilience planning, both financial and non-financial, and require engagement planning with the main stakeholder groups. In addition, they recognise ESG issues as a matter of fiduciary duty, addressing the derived risks through corporate stewardship, research, innovation and public commitments.

Adding to this complexity, some sustainability-related issues play out over the long term and are tied to future trends that can have a major impact on real-estate investments. Take climate change for example. With the growing number of weather-related disasters occurring around the world ? another one-in-100-year flood has hit Sydney in November 2018, causing an estimated A$10m in damage ? there is a growing realisation that property investors are particularly exposed.

Calculating the future economic effects of climate change is not easy. The equation first needs to incorporate the effects of changing global temperatures on local weather conditions, then calculate the effect of these changes on macro indicators that could affect local productivity and national GDP, consider exposure to grid constraint risks, the potential for regulation, shifting consumer behaviour, energy supply and, in turn, how these affect real-estate prices.

Climate change is costly precisely because it is difficult to predict and contributes to a company?s risk profile as a macro stress factor. A recent analysis combining Maplecroft Risk indices and GRESB data demonstrates that risks associated with carbon emissions and climate change adaptation are not well accounted for compared to risks related to social and governance aspects. Despite being acknowledged, not all such risks are generally understood in quantifiable terms by real-estate investors.

*Calculating the future economic effects of climate change is not easy as the equation must incorporate the effects of changing global temperatures on local weather, then the effect of this on macro indicators*

Specific questions on energy and water efficiency, on the other hand, are better understood, and continue to be of interest to investors. But in many cases they are considered in terms of the operational costs they save when their benefits can be far broader. For example, investments in energy and water efficiency can be quickly reflected in the form of tax rebates, improved valuations, a lower chance of obsolescence, discounts on insurance premiums and even higher rental income and occupancy rates.

The business case for considering ESG performance is constantly evolving, reflecting changing expectations and contexts. In the years since the first GRESB assessment in 2009, the conversation has broadened to include socially driven initiatives such as the health and well-being of tenants, neighbourhoods and communities. This is reflected in attention to issues such as indoor air quality, location, services and material selection.

Unlike the demand for efficiency and low-carbon buildings, which have been traditionally driven by the investor community, the interest in health and well-being issues stems from tenant or user preferences and employee expectations. Both groups are becoming more discerning about what they expect from a leased space or a workplace and, as a result, the best commercial real-estate companies no longer think of health and safety as a risk that must be minimised but as an opportunity for differentiation. These companies have been using health and well-being as a broad area of value creation and are adapting their practices to appeal to future generations of tenants, buyers and employees.

## Sustainability studies

Taken as a whole, the research on the business case for ESG performance in the real-estate sector is vast and diverse. There are numerous academic studies finding a positive link between particular aspects of ESG performance ? often the environmental ones ? such as building certifications and financial performance.

A 2012 RICS report  on the value of green buildings found that ?BREEAM-certified properties command a 28 per cent premium over non-certified properties, controlling for basic building characteristics?. There are also a growing number of case studies on how individual companies or funds have gained or lost as a result of specific social or environmental factors. More recently, scenario-based assessments have emerged, highlighting locations or asset types poised to gain or lose from sustainability issues.

In the end, there is no single business case for action on sustainability. Instead, there are multiple measures of business success ? some narrow, some broad, some tangible and some intangible ? and each real-estate fund or company has to develop its own rationale. The baseline premise is often intuitive: good ESG performance is a proxy for good management. After all, it?s simply a sign of good strategy, at both the organisational and asset level, to keep the tenant, customer, employee or community member happy. More often than not, the cost of not investing in suitable measures becomes higher than the cost of investment itself. Our investor members recognise this, as do the real-estate managers who participate in our assessments.

The main factor that continues to limit the ability to use ESG data in investment decisions is the lack of data availability, data comparability and data accuracy. That?s why GRESB focuses on offering a reliable, robust ESG benchmark, based on high-quality data.

Today, and even more so in the future, stakeholders will demand the right kind of information when making critical decisions, defined by relevance, completeness, accuracy, timeliness and lineage or auditability. Our ultimate aim is to bring ESG data quality on to a par with that of financial data and continue to transform the way real estate approaches sustainability.

**Roxana Isaiu is director, real estate at GRESB**

## Further information

- Related competencies include: Sustainability
- This feature is taken from the RICS Property Journal (March/April 2019)
- Related categories include: Real estate performance and Sustainability for surveyors