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Real Estate Investment Management in the light of ESG

How to navigate through the ESG jungle to define and implement a future-proof organization



Over the past years, the relevance of real estate funds with an ESG-focus has increased. While some players managed to establish themselves successfully as sustainable Real Estate Investment Managers (REIMs), others only did little to prepare their organizations for this shift.

With regulatory compliance being the first priority, some players dedicated a large part of their recent efforts ensuring the required regulation is implemented – which felt more like a box ticking exercise rather than incorporating the ESG potential in their long-term strategy. However, one thing is clear: REIMs must react now to create a profound basis for their future business. Having realized this, the first step includes the definition of an individual ESG ambition level – meaning, REIMs have to define whether and to what extent they aim to integrate ESG criteria across their value chain. These questions go way beyond regulatory considerations.

To comply with the Paris Agreement, the global average building energy intensity per square meter must shrink by at least 30% by 2030¹ – a massive undertaking. Therefore, the sector is in the spotlight of politicians and regulators, experiencing a continuous pressure for mitigation efforts.

Besides tightening building regulations (e.g. Energy Performance of Buildings Directive), REIMs experience extended disclosure obligations according to the Sustainable Finance Disclosure Regulation (SFDR) and the EU Taxonomy (see also ESG RE Insights article no. 1). Enforcing a higher transparency and setting the criteria for a common definition of activities that are environmentally sustainable, those regulations allow for better comparability of investment products. They set a new pace for the industry, requiring REIMs to align their business.

However, not only regulations drive the industry to shift towards more sustainable and transparent strategies. Two years ago, a study conducted by UNEP FI, Brentall Kennedy & REALPAC among 44 fund managers, asset managers, and REITs representing more than USD 1 trillion assets under management, found 83% of the respondents to experience an increase in investor demand for sustainability performance disclosure². Since then, we saw this trend progressing steadily. Our expectation therefore is that the number of ESG or impact products will rise and that sustainable strategies will accelerate even further, with conventional funds being put under pressure as the offer of green funds increases.

One thing is clear: to account for this market shift, REIMs must define and implement a sustainable strategy to create a profound basis for their future business.

If not, they may suffer from reputational damage and decreasing investor demand. While not suggesting a REIMs offering should purely focus on ESG-impact products, it rather implies that investment managers need to ensure having a clear vision on to what extent they aim to implement ESG in their products, assets, and their organization.

What we currently see on the market is that many REIMs are trying to establish themselves as “ESG players”. In some cases, this is strongly driven by the ambition of labelling products as green (e.g. according to article 8 or 9 of SFDR), but lacks a clear long-term concept involving the entire organization. With regulatory compliance being the first priority, operationalising a long-term strategy in some cases falls out of sight. It seems as if some players in the industry dedicate a large part of their efforts to extinguish fires caused by new regulatory requirements and a long-term denial of the topic’s importance.

Defining a sustainable ESG-strategy considering a REIMs individual ambition level

To unravel these circumstances, defining a sustainable ESG-strategy on company, product, asset, and data level is key. Preliminary task should be the definition of an individual ESG ambition level, meaning REIMs should define whether and to what extent they aim to integrate ESG criteria across their value chain. Key questions to answer within that stage are:

- (a) Does the REIM want to manage/sell ESG products?
- (b) Does the REIM want to act solely as an adopter or does the company aspire a pioneering role?

¹ Global Alliance for Buildings and Construction (2018) – https://wedocs.unep.org/bitstream/handle/20.500.11822/27140/Global_Status_2018.pdf?sequence=1&isAllowed=y.

² UNEP FI, Brentall Kennedy & REALPAC (2019) – <https://www.unepfi.org/wordpress/wp-content/uploads/2019/03/Global-ESG-Real-Estate-Investment-Survey-Results.pdf>.

Setting the grounds for strategy implementation

With that being answered, the ESG strategy should be derived in-line with the individual ambition level. This includes the definition of concrete measures across the entire value chain. While players who do not want to focus on managing/selling ESG products only need to comply with certain regulatory requirements (e.g. disclosure requirements according to SFDR), adopters or pioneers should already consider measures that go beyond that (see fig. 1). In a second step, defined measures should be prioritized, linked to a realistic timeline, and assigned to resources. Finally, it is key to establish a steering

model that enables the measurement of performance and success during and after the implementation.

Altogether, REIMs defining and implementing a concrete ESG strategy will set the grounds for a future-proof organization and gain competitive advantages. We clearly see those with a mature ESG organization increasing their attractiveness to various stakeholders: from employees to investors and tenants. Hence, as REIMs navigate through the ESG jungle the big picture in defining and implementing a future-proof organization should be considered – instead of focusing purely on regulatory compliance.

Fig. 1 – ESG ambition levels incl. obligatory and voluntary measures on company, product and data level (non-exhaustive list of examples)

| Minimum ESG Adopter Pioneer | | |
|--|--|---|
| Minimum ESG | ESG Adopter | ESG Pioneer |
| <ul style="list-style-type: none"> • Only offering conventional products • Avoiding compliance conflicts and mitigating reputational risks • Complying with regulatory minimum requirements | <ul style="list-style-type: none"> • Besides conventional products, offering article 8 and 9 products according to SFDR • Clear definition of ESG strategy incl. vision and concrete initiatives • Definition of central ESG responsibilities • Training relevant employees to establish ESG knowledge • Non-financial reporting according to NFRD, SFDR reporting, Taxonomy reporting, and TCFD • Participating in external ESG-scoring • Providing option for green leases • Organising the data collection by defining clear processes and responsibilities, and creating the technical and legal basis for data gathering • ... | <ul style="list-style-type: none"> • Only offering article 8 and 9 products according to SFDR <p>Similar to ESG Adopter plus:</p> <ul style="list-style-type: none"> + Integration of ESG along the entire value chain + Regular external ESG-audits + Embedding ESG responsibilities among C-levels + Actively pursuing latest ESG trends and setting the pace for the industry + Integrating ESG criteria in salary models + Managing servicers according to their ESG targets (bonus/malus system) + Executing extensive analyses based on ESG data and deriving concrete measures for property management + ... |

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