



ESG Talks: Opportunities & Challenges in Real Estate Investment Management Edition #2

Series Background

ESG (Environmental, Social and Governance) is arguably one of the most discussed topics in the real estate industry, driven by growing public interest in sustainability and new regulatory requirements. Real Estate Investment Managers (REIMs) in particular are strongly affected by this and face various challenges, since ESG requires a broad change of perspective in many business areas. Therefore, as part of this publication series, Deloitte examines the real importance attached to ESG, the

approaches REIMs are taking, where there is room for improvement, and what can be expected from the industry in the future.

The content of this series was collected and analyzed between August and October 2021. In a total of 16 hypothesis-driven interviews, 22 managing directors and department heads of leading European and global REIMs based in Germany and global REIMs based in Germany were surveyed. Thus, the participants represent approximately € 600 billion in real estate assets under

management. The aim of the interviews was to obtain a meaningful picture of the industry on the topic of ESG in order to highlight not only challenges and risks, but also potential solutions and opportunities. The interviews were conducted based on seven hypotheses that participants had to ultimately agree or disagree with in the otherwise free-form conversations. Deloitte now publishes a Point of View at regular intervals as a summary of the interview results for each hypothesis. ➔

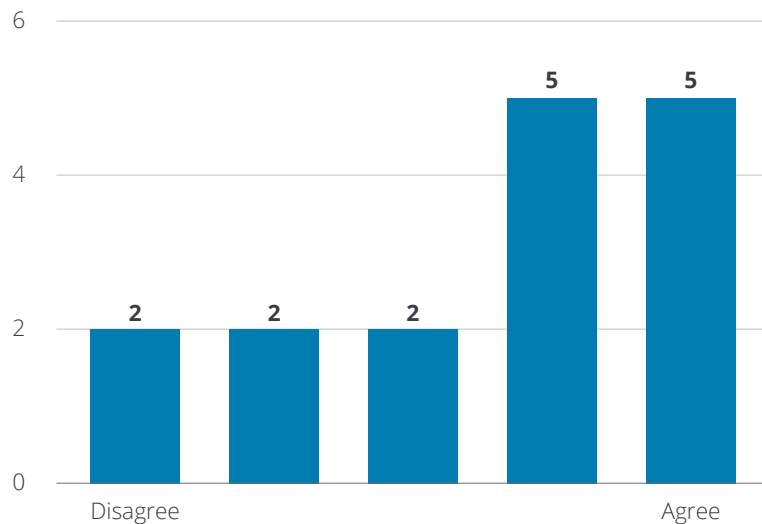
Discussion of Hypothesis #2

“The sum of individual efforts by REIMs is not enough to achieve the ambitious climate targets of the EU Green Deal. Competitive thinking and a lack of trust confront the industry with obstacles when it comes to collaboration among competitors.”

The size of the German real estate market amounts to approx. 14 tn. €, more than four times Germany's gross domestic product (GDP).¹ Of this, only around EUR 175 bn. is held in real estate funds.² These figures demonstrate that the REIM industry represents only a fraction of the total real estate market. As a result, the REIM industry has a limited impact to the overall fulfillment of climate targets. Bearing this in mind, the hypothesis only considers the relative goals of the industry and assumes that these targets cannot be achieved without cross-collaboration between market players.

The survey results display a consensus in line with our hypothesis. In addition to the important role of EU regulations and the public sector, which define the framework through legislation, industry associations also have a key responsibility. The interview participants emphasize the importance of harmonized ESG standards to achieve a certain level of measurability. While most initiatives in Germany are regarded as productive and collaborative, REIMs with a global presence criticize the focus of many initiatives on the domestic market.

Fig. 1 - The sum of all individual efforts by REIMs is not enough to achieve the ambitious climate targets of the EU Green Deal



„Objective sustainability standards are important for the industry, but they will only help us if we can measure ourselves against the competition internationally and thereby make an impact.“

Clemens Schäfer, Global Co-Head of Real Estate, APAC & EMEA, DWS

¹Zentraler Immobilien Ausschuss e.V. (2021): <https://zia-deutschland.de/project/bedeutung-der-immobilienbranche/> accessed 10.11.2021).

²Bundesbank (2021): <https://www.bundesbank.de/resource/blob/804052/cecfb67bc7d8482bd402071a876ea694/mL/0-investmentsfondsstatistik-data.pdf> (accessed 10.11.2021).

We see a great deal of consensus that dialogue within the industry is beneficial. The initiative from "ECORE" (ESG Circle of Real Estate) was emphasized in the interviews, which according to the interviewees is seen as open and transparent. However, the interviews also quickly revealed the limits of this collaboration. True cooperation between competitors is currently not on the agenda of any of the firms, although many players are convinced that a healthy competitive spirit promotes the development of ideas and thus innovation. According to the respondents, pursuing their individual goals is the main driver of success. As ESG is currently regarded as an important instrument for gaining a strategic advantage over competitors. Close collaboration with competitors who are not yet as well positioned, could in fact jeopardize this advantage.

Overall, however, there is a consensus that the entire industry needs to pick up speed on the issue at hand. Firms must now embrace the required transparency and should expect regulatory requirements to tighten further in the future. If they fail to do so, "the sheep will separate from the goats". Above all, the respondents anticipate legislative restrictions on existing buildings, e.g., regarding heating systems, renovations, and energy prices.

„It is important not to stand still but take ESG actions now. Even small things contribute and have an impact.“

**Christoph Mölleken, Managing Director,
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Conclusion („So what?“):

Most of the firms interviewed have high aspirations when it comes to ESG and are driven to make an impact beyond simply meeting regulatory requirements (see point of view on hypothesis 1). Nevertheless, those interviewed are divided as to whether the sector will achieve its climate objectives. While some are confident that the further tightening of and ever more precise legislation along with evolving standards will be sufficient, others see major challenges in the renovation of the existing building stock. Low renovation rates of around 1% per year, limited building capacities and the need for climate-neutral construction materials are all major obstacles. Therefore, the respondents would like to see the government play a more substantial role by adapting legislation and their implementation on our way to a more sustainable building stock. Whether the industry will use cross- or lateral collaboration to pick up momentum is still debatable.

Outlook

This point of view is part of a seven-part series that will be published between Q4 2021 and Q1 2022. Each publication presents one of the hypotheses discussed during the interviews.

Hypothesis #1

“ESG is a marketing tool. The industry puts its image and regulatory compliance ahead of delivering real impact.”

Hypothesis #2

“The sum of individual efforts by REIMs is not enough to achieve the ambitious climate targets of the EU Green Deal. Competitive thinking and a lack of trust confront the industry with obstacles when it comes to collaboration among competitors.”

Hypothesis #3

“REIMs cannot implement a ‘manage to green strategy’ on their own. Collaboration with tenants and service providers is essential for this. However, concrete initiatives are still missing.”

Hypothesis #4

“The most sustainable building is the one that is not built.”

Hypothesis #5

“The costs of constructing, refurbishing and operating sustainable buildings will exceed the economic benefits. Sustainable investors will therefore have to forego returns in the future.”

Hypothesis #6

“The integration of ESG along the entire value chain is costly and comes at the expense of profits from management fees. However, the scope for adjustment is moderate. Efficiency pressure on existing business is increasing.”

Hypothesis #7

“An ESG scoring/rating is only as good as its underlying data. The incomplete data basis and the need for extrapolation pose major challenges for REIMs.”

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