



ESG Talks: Opportunities & Challenges in Real Estate Investment Management Edition #3

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

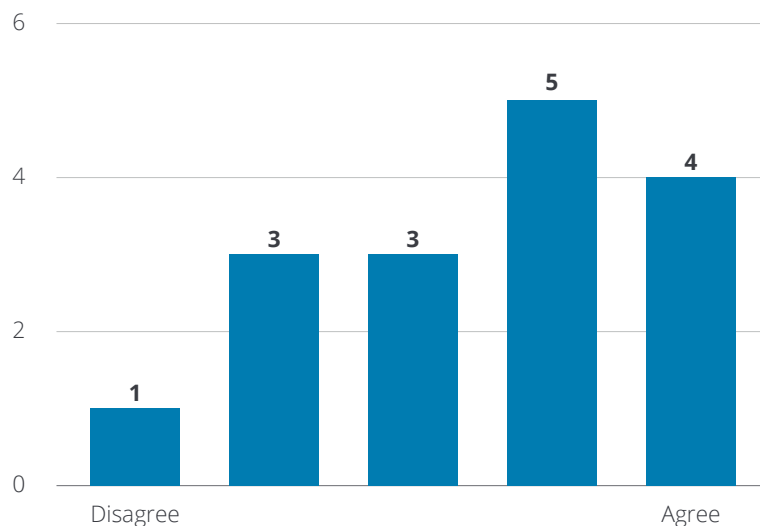
management. The aim of the interviews was to obtain a meaningful picture of the industry on the topic of ESG in order to highlight not only challenges and risks, but also potential solutions and opportunities. The interviews were conducted based on seven hypotheses that participants had to ultimately 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 #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.¹”

After discussing horizontal collaboration between competitors in hypothesis 2, the focus now shifts to vertical collaboration between real estate investment managers (REIMs) and tenants or service providers. In principle, the hypothesis was accepted, particularly in view of the general need for collaboration along the real estate value chain. A key argument for this was, among other things, the fact that the influence of the REIM on the overall energy consumption and CO₂ footprint of a building is limited. Thus, the improvement of the carbon footprint cannot be achieved without collaborative approaches with tenants and/or service providers. At this point, our interviewees reported that sustainable management at the property level is not yet anchored in the day-to-day business of all players, and that in property management, for example, services are still being tendered solely on the basis of economic considerations, without taking sustainability aspects into account. However, even concrete impulses from the REIM to ensure more sustainable management towards the tenant do not always meet with acceptance or are not heard enough. Particularly in the case of multi-tenant properties with small-scale lease structures, it is comparatively more difficult to implement uniform approaches to sustainable building management with tenants and service providers alike. It should be noted that the operational implementation of sustainability aspects at the building level depends on the competence and capacities in property and facility management of the respective service providers. While the proactivity of the REIMs is a clear prerequisite, it will not work without collaboration with the service providers in operational building management. New requirements are currently being defined here, which ultimately entail higher expenses.

Fig. 1 – 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.



„Collaboration is essential in ESG – with industry partners as well as developers, cities, tenants and other stakeholders. A collaborative approach is required.“

Dr. Raphael Mertens, Chief Risk Officer, Global Head of Sustainability, Allianz Real Estate GmbH

¹ The agreement/disagreement of interviewees refers to the second and third part of the hypothesis.

Even though sustainability has now achieved macroeconomic priority for good reason and is generally a core strategic issue across industry boundaries on the tenant side as well, it is implemented differently operationally by the respective industry representatives. A logistics company, for example, will first deal with the fleet and supply chain in its own efforts in favor of a Net Zero strategy and less with the logistics hall and its primary energy consumption or CO₂ emissions. It was also reported that, especially in large-volume leases with public sector players, other aspects outside of sustainable building management are sometimes prioritized in lease negotiations. Other sectors, such as banks or insurance companies as office tenants, on the other hand, sometimes proactively drive collaboration in the form of green leases, especially if they are (self-) obligated to publish sustainability reports. However, a cross-industry “tenant push” was not reported in our interviews.

The last part of the hypothesis was largely contradicted. Most of the interviewees were aware of concrete initiatives, be it

individual measures in their own portfolio or cross-industry initiatives such as ECORE, the ZIA Green Lease Guidelines (2018) or the various initiatives to define a common data standard.

In general, collaboration in the context of a “manage to green strategy” depends on individual contractual agreements between REIMs and service providers or tenants and thus the principle of contractual freedom. This is not least due to the fact that there is currently no legal instrument that allows the REIMs access to consumption data of the rental spaces. Furthermore, a distinction must be made here between existing and new contracts, where it is the former in particular that make it more difficult for the REIM to implement sustainable measures (in terms of construction or data) in cooperation with the tenant. As long as the legislator (in Germany) is not expected to make any adjustments here, concrete initiatives between landlords and tenants are the main driver for profitable cooperation, especially with regard to the necessary collection and evaluation of consumption data.

Conclusion

There was general agreement on the need for vertical collaboration along the value chain. Controversially, we discussed the existence of concrete initiatives. Many REIMs have already implemented various initiatives at the single asset, portfolio and or product level, but an industry-wide standard for collaboration with tenants and service providers has not yet been found. In addition to the lack of legal authority for data collection by landlords, the mismatched sustainability agendas of tenants and REIMs are often salient. Here, the ongoing initiative of the REIM as well as the establishment of a new tenant proximity is required to optimally harmonize the respective sustainability agendas with regard to the operation and management of the property. Especially in view of the development of CO₂ pricing and the associated increase in operating costs of “conventionally” operated buildings, the exchange of consumption data between tenant and REIM would offer significant potential for optimizing consumption and thus provide real added value for both management by the REIM and operation by the tenant.

„If the climate targets are really to be achieved, it is not enough just to talk about them all the time; in individual cases, the necessary measures should be given legal priority.“

Markus Niedermeier, Managing Director, LHI Group

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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