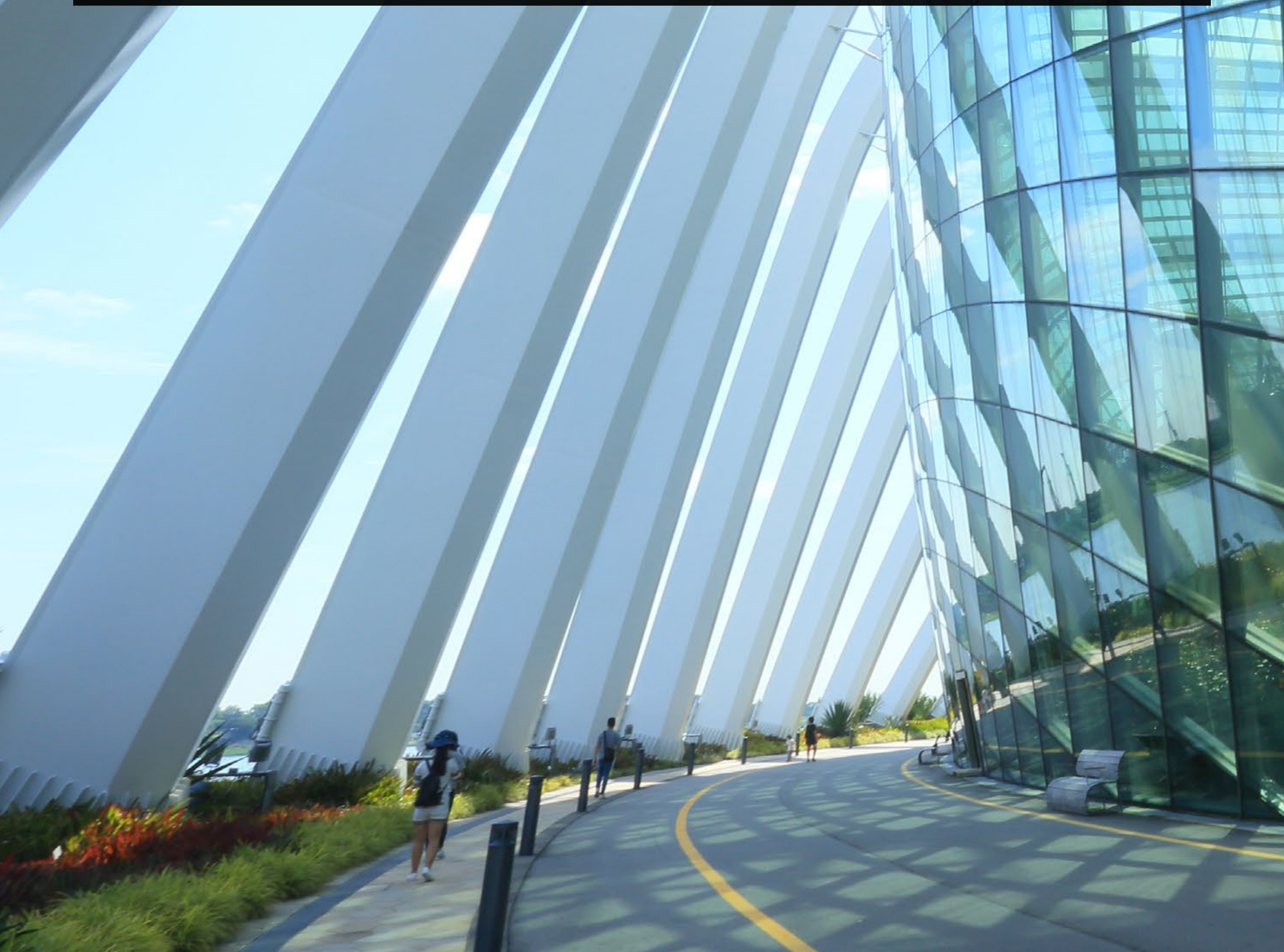
CHALLENGES AND OPPORTUNITIES IN REAL ESTATE ASSET MANAGEMENT

Interview with **Christy Hill**

Head of Americas Asset Management and Global Head of ESG at PGIM Real Estate



CHRISTY HILL

HEAD OF AMERICAS ASSET MANAGEMENT
AND GLOBAL HEAD OF ESG AT PGIM REAL ESTATE

Real estate asset management is currently being shaped by trends such as ever-increasing interest in ESG, proliferation of technologies and the digitalisation of operations. Integrating ESG aspects in overall strategy, capturing new types of data and finding ways to leverage that data, as well as applying analytics, are just some of today's challenges in real estate asset management, but those challenges also present opportunities to be seized. While the fundamentals of good asset management haven't changed, the available tools, mindset and skills required to use them are evolving more rapidly than ever.

Deloitte US Real Estate Leader John D'Angelo speaks with Christy Hill, Head of Americas Asset Management and Global Head of ESG at PGIM Real Estate, about how these trends are impacting ESG strategy and Asset Management at PGIM Real Estate.

A trend we see is that asset management hasn't been focused on leveraging analytics - do you see the same thing and is there an opportunity to increase leverage of data and the use of analytics in the asset management function?

We have been leveraging data in Asset Management forever. Whether looking at construction costs, general market trends, demographics, tenant credit or lease and sales comps, we have always leaned on this information to inform our decision making. I think the big change is that the data we now have access to is getting more robust, is more readily available and is easier to use thanks to technological advancements. All of these changes are allowing us to be more efficient and thoughtful about the way we use and analyse our data. And, because of this improved efficiency, we are now even more focused on how to expand our data collection so that we can gain even deeper insights to shape our strategies.

As technology continues to improve, I am a believer in the notion that he or she who has the most data will win, assuming that the data can be dissected in a meaningful way. The key is having a platform that facilitates analysis and interpretation so that we're able to extract the greatest benefit from the insights we glean from our data and be nimble in the ways that we use it. As with many areas, COVID-19 has really shined a bright light on the importance of data and data collection as we have worked to manage through this crisis – for us, that meant effectively tracking cases, collections, occupancies and the impact of the pandemic on our building operations and systems. Working remotely for the past year has also highlighted how important it is to be able to access and use data from anywhere at any time.

Do you see, as a shift within PGIM Real Estate or more broadly across the industry, that data matters, that having trustworthy data matters, and being able to have the capacity to do something with it matters in a way that people did not see pre-pandemic?

Trustworthiness and PGIM Real Estate have always gone hand in hand, so we have always been incredibly focused on accuracy in general – including data accuracy – and always will be. The thirst for data has definitely been more pronounced in recent years and it's not a surprise that this is a trend that was very much accelerated by the pandemic. While many firms are just starting to recognise the importance of this, the shift at PGIM Real Estate is that we're focused on making data a competitive advantage, and having a more than 50-year investment heritage helps give us that edge. With a $188 billion global portfolio across real estate debt and equity, we are in a unique position to leverage and combine the best of third-party data providers with our robust proprietary data set. As one of the largest owners in the world, we think we are well-positioned to capitalise on the insights on which we can draw from within our own walls for the benefit of our investors and partners and, because it is our own data, we can also be substantially more confident in its accuracy. Certainly, data accuracy and data security will always be a priority.

There has also been a surge of funding in the PropTech space. As a result, the industry has better access to tools and information that have not historically been available. This will benefit the smaller organisations that don't have the data sets like PGIM Real Estate has to draw upon, making them more competitive as well. However, I do continue to beat the drum on accuracy. The space is evolving quickly, and data is useless if you cannot rely on it. I once heard someone say "Data that is 80% accurate is 100% useless", and we all need to remember this!

What has changed since you started in asset management?

Not as much as you would think; we are slow adopters in the real estate industry. When I think about my role as an asset manager 20 years ago, I was buying/selling, budgeting, business planning, leasing and interacting with the property manager. While markets evolve and strategies shift, fundamentally, those activities haven't changed.

One of the biggest changes, however, is the importance of ESG and resilience in real estate investing. For years we have focused on the "E" and sustainability gained traction because of the ROI and impact on the bottom line. The combination of COVID-19 and the social unrest and injustice we have witnessed over the past years has really shined a bright light on the importance of ESG broadly.

We have seen how COVID-19 has impacted underserved communities disproportionately. We are now very aware of the threat of climate change and how this may impact our portfolios. We also believe the impact of climate change on these underserved communities will be similarly disproportionate. ESG has become a critical consideration in our investment process and understanding that all risks we face on this front are critical to prudent investing.

Resilience is also a topic that has gained a lot of attention in recent years and is critical to the underlying strategy of any asset. In real estate, we have always looked to the durability of our cash flows. This is still the case, but we are now linking the physical and social durability of our assets to their financial durability.

This change and increased focus have not only been self-imposed but have also been reinforced by our investors who continue to elevate their focus on ESG broadly. I think it is great to see that this focus will continue to drive the industry.

However, at its heart, asset management is the intersection of where strategy meets execution, and while the areas of focus may evolve, this will always remain.

What shouldn't ever change or be different?

A deep understanding of your property and market. You need that and you're never going to solve it with spreadsheets. Asset management brings so much together; it's really about understanding the micro and macro drivers of the market, submarket and micro-market. To capture demand, you constantly need to know how you are positioned, what tenants need, what they value and what is changing in real time so that you can capture that demand.

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When I think about automation and due diligence, there are aspects of underwriting that can probably be easily automated, as well as elements of budgeting, but there is a judgement layer in what we do that will always need to stay. My worry is that data becomes a crutch when it is meant to be a tool to help us make better decisions – it is not meant to replace our decision making.

Human connectivity and connection in deal making is also really important. It's the beauty of having a tangible asset; it's bricks and mortar and you can go there and see it. If the window is broken, you see it and fix it. It's the same situation with tenants in the building and talking with them directly. You can read an article about a large employer or you can tour a property with someone at that large employer who's looking for property – and you're going to learn a lot more from the latter.

How do you see asset management evolving over the coming years, particularly in how it leverages data and analytics?

Accessibility and speed of availability. The ability to access different datasets and the ability to access it in real time are two very different things. If you wanted to find comps ten years ago, you would call four different brokers, put the details in a spreadsheet and hope the information was accurate. Today, you can access comps through your own network, but you can also buy that data. This allows us to access relevant data, digest it quickly and aggregate, triangulate and use it to make better decisions. We are spending more time being analytical and strategic versus spending time hunting and gathering the data before being able to spend time thinking about what that data means. Our level of productivity increases as we are spending less time gathering data and, at the same time, ending up with better information.

What skills do you think we'll see increasing in demand – in other words, if there is an opportunity to better leverage data and use analytics, what skills and capabilities will likely be required?

Ultimately, the skills are the same. It's an investment discipline, so understanding and analysing transactions, markets and finance remain the same. The skill that is really evolving is flexibility in using different systems and that's where the digital native entering our industry has an advantage. Being tech resistant isn't going to be successful. It's about learning how to use the platforms, understanding there is a lot of data out there, and then getting to the right source. At the end of the day, the discipline remains the same – we're buying buildings, repositioning buildings, leasing buildings and selling buildings. The financial analysis isn't changing – it's that we now have the ability to be better informed and have easier access to better data and better tools with which to analyse that data.

What gets in the way of leveraging data, tools and analytics today?

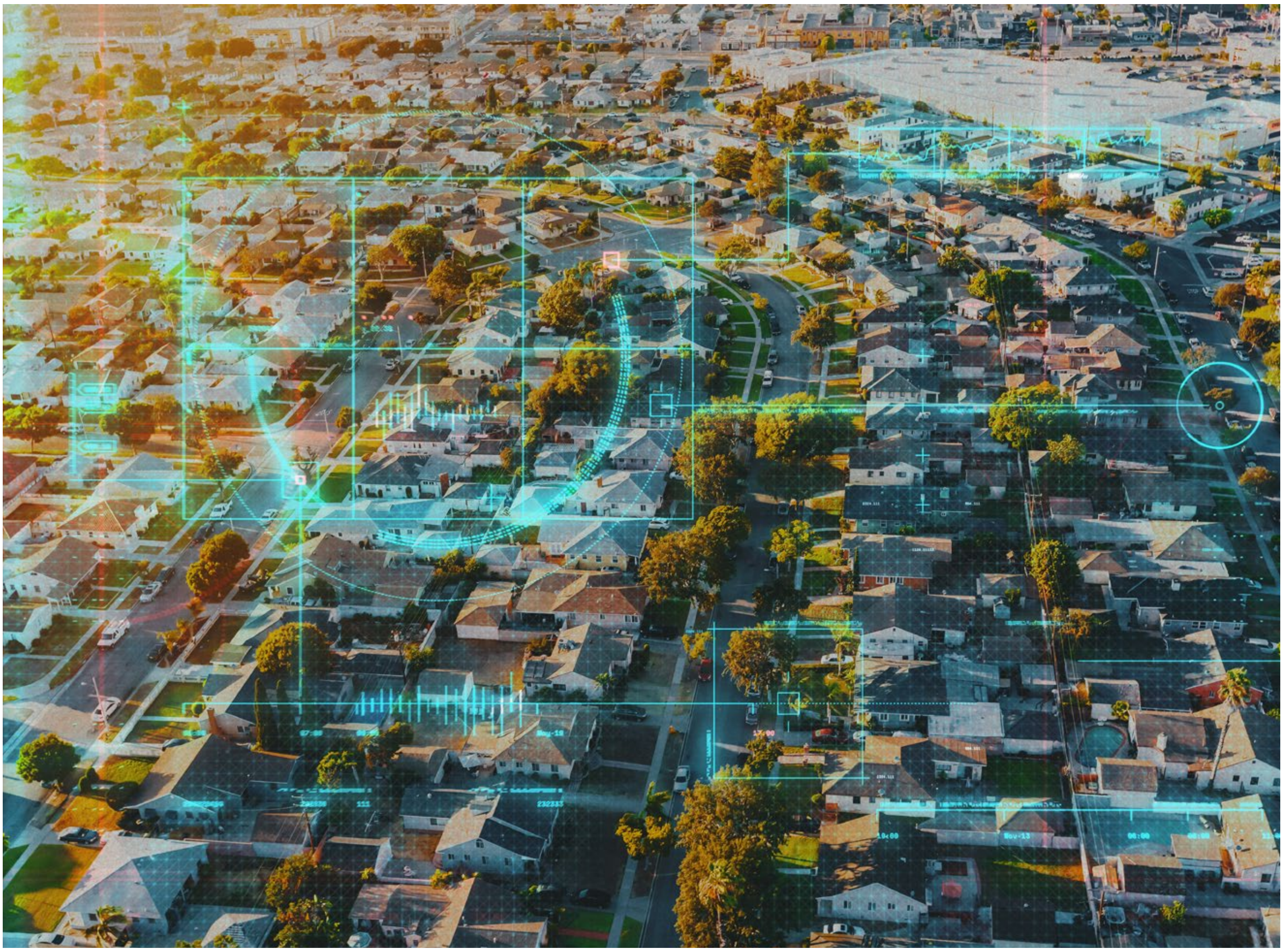
While there are always tactical challenges to any data endeavour, I think the biggest hurdles are psychological. The people who historically didn't want to collaborate and hoarded their information have a bigger psychological hurdle to overcome.

I think the greatest psychological barrier that needs to be overcome is to understand that you can only get so far by hoarding data and creating your own data silo. There needs to be an understanding that leveraging wider data sets yields broader understanding and better results. Those who are still clinging to their spreadsheets, with "their" data, will ultimately make poor decisions that will negatively impact their performance as an asset manager.

How has collaboration and leverage of technology changed in asset management?

We have all learned how to collaborate in a different way over this past year. I think this experience has and will continue to accelerate the adoption of technology. Everyone was forced to use technology and realise that technology is the way of the future and you can either get on board or get left behind. I think those who don't buy into the value of data and technology will become increasingly irrelevant. In a world where you can verify so many things, how are we going to look at the person that is still relying only on their gut? I do believe that instinct is critical in real estate but when you're a fiduciary, it's imperative to both trust and verify.

One of the biggest changes is the importance of ESG and resilience in real estate investing. For years we have focused on the "E" and sustainability gained traction because of the ROI and impact on the bottom line. The combination of COVID-19 and the social unrest and injustice we have witnessed over the past years has really shined a bright light on the importance of ESG broadly.



My premise is that over the arc of the next decade we are going to see an information / data analytic revolution coming to us, whether you like it or not. There is a change happening, not just acceleration but a reset, reboot and rethink that is not going away. Does that resonate with you?

Yes, this is happening, but let's go with it! It's going to be a massive undertaking as the industry gets its arms around all that we have access to and works to decipher what is critical. We just need to "eat the elephant" one bite at a time (so to speak). But it is a competitive space and the time we have to eat is compressing, so we may have to eat it a little quicker.

I think ESG is forcing this in a way nothing else has. So much of ESG is data-driven on the social and environmental side. If you look at the carbon neutrality commitments, you can't make that commitment without tracking your data. By this time next year, I expect we will see most major advisers making this commitment and it will be a commitment to data.

From a regulatory perspective, I expect we will see heightened requirements to track certain data going forward as well, if only on the environmental front. We are already seeing this in Europe and in limited places in the US, and I only envision this intensifying.

That's interesting. My take on it is that, as foreign investors are asking more questions and tenants are asking more about it, we have gone very quickly from something that seemed optional to something that was required in keeping an asset relevant. I am curious to know whether you see that playing forward in a post-COVID environment, with people going a step further into healthy buildings or evidencing the air quality and consumer ratings for the efficiency of buildings. Do you think that this is coming in a bigger way or is it going to be a slower evolution?

I think it's here; there are A-list celebrities advertising for healthy buildings. There was already a mounting focus on building health and the pandemic has definitely accelerated that. I think it's important to note that, as we think about ESG, those who are reluctant to adapt will be losers as well. Conveying the "health" of our assets to our tenants and the public is a critical part of the "S" in the ESG, and we need to be really thoughtful about how we track those metrics. Ultimately, we believe that a healthier building will be more durable.

Do you struggle with the ESG investment strategies you need to make (whether value-add or core plus) or are there investments that don't pencil out because of the

strategy of the hold period that would otherwise be good for the building (or does it not get in the way)?

ESG needs to be implemented as appropriate and complementary to the underlying investment strategy. You still frequently hear people say "ESG doesn't matter because I am a value-add buyer." However, if you are a value-add investor targeting a core exit, closing your eyes to ESG is likely closing your eyes to something that is important to the next buyer. As a result, failing to focus on this could result in a less successful execution. Theoretically, in a world where ESG matters to your core buyers, over time, a building with a better ESG profile will price better. If it's more resilient, a buyer should have more conviction around the cash flows which could lead to different pricing on a risk-adjusted basis. ESG is not one-size-fits-all for a multitude of reasons. It's possible to have different and successful ESG implementation across strategies.

Do you see uses for sensor/IoT data (i.e. occupancy sensors and data that can come from connected devices) from assets that may help asset managers get a better view of what's happening at a given asset and the risks/opportunities associated with that?

We are already using this technology in a number of ways and our building engineers focused on building systems have been leveraging this technology for a while now. We're heading in a direction where we can use sensor data as a strategy to act proactively instead of reactively. The key is extracting that data to be strategic, targeted and tactical in how we use it. Using data to inform and reform our strategies to be more targeted and tactical allows us to deliver on the proposition of reducing consumption, but also allows us to fulfill the investment promise as well.

Now that it's easier to see a building's resource consumption data, how closely do you look at that data and what do you do with it?

We're accountable now and, as owners of these buildings, this is an imperative. The notion that ignorance is bliss is by no means acceptable. We need to hold ourselves to a higher standard given the impact that real estate has on the environment. If you asked me 20 years ago to consider how we are going to monitor consumption, I couldn't answer the question then, but I can tell you now - exactly how and what we're doing building by building.

How important do you believe it is today, and will be in the future, to evidence that your buildings are smart, safe, healthy and responsible?

Buildings will need to get smarter to attract tenants. It's becoming basic marketing, especially for larger corporate firms and public companies, and they will start to have exclusionary screenings around the qualifications of buildings. Buildings will have to be smarter and healthier not only to support ESG goals but to support the investment proposition so that we capture more than our fair share of the demand.

We do need to be mindful of the unintended consequences of smart buildings. We want our buildings to be smart and dynamic, but the downside of cloud-based systems is increased cyber security risk. You need to make sure the building is smart without being exposed to these threats. You can't think about how to make a building smarter without considering the cyber threat every step of the way. It needs to be an underlying step in every action you take.

As ever, for your office portfolio, you want to attract and retain employers of choice – what is or isn't changing in how you do this?

We believe if we deliver the best and smartest buildings, then we will attract the best, smartest and most profitable tenants. We like these tenants because they likely have superior credit. This supports both the environmental and financial objective of the investment.

Do you see us as an industry, particularly investment management, getting better at looking forward with modeling and scenario planning, and using that forward view to better inform action? In a decade, how will an asset manager be spending their time differently than today?

I believe it is an area in which we'll get better, and it goes back to the data. We now have different and more robust data sets to choose from. Tapping into the data allows us to make more informed decisions. Looking ahead even five years from now, I think we will have cleaner data and be in a better position to leverage it versus gathering it. We are already using this type of scenario planning with climate risk, so the muscle memory is building.

Thinking about where we're heading, what is the most exciting thing for you?

Our ability to drive change while simultaneously driving financial performance is the most exciting thing for me. I am excited about our ability to impact positive change on the environmental and social front while delivering on the investment promise for our clients. As a large organisation, we have the ability to be an example and a leader to others and demonstrate that in real estate there can be an alignment of these objectives.