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Driving ESG leadership
across the built environment.
Facilitated discussion
18 November 2021.

Leaders of the pack.
Driving ESG in the built environment: round the table with Reuters.

Last month we designed a workshop, facilitated by global news network Reuters, to explore the new risks and opportunities arising for investors, asset owners and developers as ESG considerations gain increasing importance across the built environment.

With Head of ESG Diana Sanchez, our Sustainability Directors Ashley Bateson and James Ford welcomed senior representatives from GRESB, Stanhope, Derwent London, MN, PGGM Investments, Unibail Rodamco Westfield, World Green Business Council, DWS, UNEP FI, Sixth Street and Landsec to talk about joining up ESG funding objectives with a genuinely sustainable built environment.

Diana Sanchez,
Head of ESG

Ashley Bateson,
Sustainability Director

James Ford,
Sustainability Director

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The key takeaways.

'Green value' and 'brown value'
It's too early to get full industry consensus that there is 'green value' and 'brown discount' appraisal of assets across all sectors, but that's definitely the trend. The suggestion is that over the next few years we may see full consensus as risks of stranded assets become more visible.

Identifying differentiators
Some sectors (offices spring to mind) have a clearer green value distinction than other sectors, such as residential, where the differentiators in the product are harder to identify.

COPping on: valuable lessons learned
The pandemic has helped society appreciate the importance of the natural environment so there hasn't been a reduction in environmental interest like there has been with previous financial recessions – arguably, the opposite has happened. COP26 has also helped raise the profile of climate change and the net zero agenda. The continued reinforcement of the ambition and need to target the 1.5-degree limit has provided necessary clarity for both investors and developers.

Short-term troubleshooting
It's increasingly clear that laggard assets are likely to diminish in value (become stranded) but that doesn't necessarily mean that premium assets are (yet, at least) going to increase in value to a large extent, which is a problem for short-term investment.

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Carbon considerations across the board
Operational carbon has been a big focus in recent years, and there is more knowledge on this, but interest in assessing embodied carbon is gaining traction. Some leading developers now want whole-life carbon assessments to be undertaken on every project (covering embodied and operational emissions).

Thinking bespoke
There needs to be a recognition that the same actions can have very different carbon impacts across different geographic markets; down to the fact that baseline carbon emissions are very different in Sweden versus Poland, for instance.

Fit for the future
Investors and developers need to be mindful of future-proofing assets based on projected climate-related scenarios. The current default is to build for now and to comply with existing requirements and industry norms. But this means buildings being approved now are not fit for purpose when they're built, as expectations of owners and occupiers are changing so fast.

> The direction of travel is moving quickly to conversations and appraisals focused on the whole lifecycle of buildings

#NoFilter?
ESG funds are often generally focused on filtering out risk to avoid investments in risky or stranded assets. There are now, however, investors that want to make a positive impact with meaningful change. There is a trend moving away from just managing risk mitigation to adding value and delivering better long-term outcomes. For example, there are emerging European funds that want to influence development to be better, say 25% lower carbon emissions, than standard new practice.

A rapidly evolving discourse
The direction of travel is moving quickly to conversations and appraisals focused on the whole lifecycle of buildings. Resource use, waste, circularity, intended use are all key considerations being factored in from the start on both acquisitions and new developments.

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We also discussed funding priorities for new development...

Old versus new
New buildings have a better pre-defined process for setting carbon and sustainability targets, compared to old building stock acquisitions. For example, building certificates such as EPCs, BREEAM and LEED ratings allow developers to set targets for new developments.

Mind the gap
There are widespread performance gaps in the built environment, ie. buildings often don't achieve the expected energy efficiency/carbon reduction/ sustainability expectations in operation. Getting performance data is crucial in addressing this. Investors will want more assurance that ESG funds are delivering intended outcomes and not just promises. Outcomes will matter but there needs to be more joined-up understanding of commitments, actions and outcomes.

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Gathering intel
Data is becoming increasingly important. But in order to verify and assess data, that data must exist. Smart design and management approaches incorporating leading-edge technologies for this purpose are gaining traction across new builds.

> **There can also be social evaluation criteria so that investments in, say, housing for key workers such as teachers and nurses, is seen as a positive thing to invest in.**

The real measure of success
Some leading developers now understand and require that success should be measured during operation, and that building certificates, which are awarded at construction completion, no longer provide enough demonstration that the building will be sustainable in practice. Other sustainable performance metrics are also gaining interest in the ESG funding community, including health and wellbeing of the building occupants and climate resilience of the asset.

Societal investment
There can also be social evaluation criteria so that investments in, say, housing for key workers such as teachers and nurses, is seen as a positive thing to invest in. However, there is awareness that key workers can't afford high rents to provide a good return on investment so developers will have to look at other parts of the development, such as the private rental accommodation, to contribute to the return on investment.

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Beyond compliance
Design for performance provides assurance that energy intensity targets will be met in operation. It requires building energy use to be verified a year after occupation. This goes beyond compliance with minimum building regulations. Some investors are saying they will want ongoing carbon reductions in their stock, such as a 5% carbon reduction every year or 15% reduction over three years.

The wider context
Cities and governments setting zero carbon targets and climate declarations help demonstrate the direction of travel for public policy. This helps to show public priorities to investors and developers and accelerates market evolution.

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...And talked about tackling the existing real estate challenge.

Getting past the go-to

Historically, the challenge of retrofitting existing buildings means that, often, developers see knocking down and building again as the most cost-effective option. This is changing. The default isn't new-build anymore. Awareness and pressure from stakeholders around sustained carbon reduction and net zero targets are driving this. The default position across a lot of development now is 'have all opportunities for refurbishment been exhausted?' The Architect's Journal 'RetroFirst' campaign supports this approach. From a carbon reduction perspective, reposition/refurb versus redevelopment is not necessarily as binary as this. Sometimes, due to structural restrictions or proposed changes in use, retrofit interactions may not easily be able to meet future expectations for the building. So a case-by-case appraisal is required.

Non-binary builds: the evolution of the middle ground

Hybrid approaches are becoming more common in appraisals to evolve existing stock. It doesn't have to be complete refurb/refit or knock down and start again. There is a lot of middle-ground opportunity. There's a strategic imperative now for development organisations to look at retrofit first, as this is arguably the single most impactful action that can be taken to support science-based targets (SBTs). It was suggested that those investors and developers who focus primarily/exclusively on new build are in denial of the task ahead of us. Given the existing stock inventory, at least in the developed world, there are very few spatial needs that really require a complete new build.

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Going forward

Embodied carbon is starting to get more attention. Increasingly, developers are seeking whole-life carbon assessments to be undertaken to inform their decision-making. It would be useful to determine clear definitions of what sustainable investment really means to provide clarity across the marketplace. We are likely to see consensus emerge as asset appraisals become more standardised, more data becomes available and ESG funding criteria become more sophisticated.

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