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ESG "Who Cares Wins"

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Published by Anastasia Klein

ESG has been on the agenda for responsible businesses for some years now. Whilst the impact of the current situation has had a devastating impact on people's health and lives and on the economy, it has also created a renewed focus and impetus to push forward ESG.

The environment is starting to recover with remarkable speed, and the way in which we are now using space has prompted people to ask how we can operate the built environment more sustainably and safely. We have also seen significant strides in terms of social responsibility demonstrated by the property industry towards local communities.

Whilst ESG affects all parts of the property sector, this article seeks to consider the impact of ESG on occupiers, landlords and investors in the retail sector specifically.

There is no set definition of ESG but it broadly covers environmental, social and governance issues.

- Environmental covers things such as:
  - climate change;
  - energy efficiency; and
  - sustainability

- Social covers:
  - community engagement;
  - impact of buildings on occupiers and the surrounding communities;
  - impact of technology on how we live, shop and interact; and
  - socio-demographic changes, such as ageing population and experience driven consumers

- Governance includes:
  - culture
  - diversity
  - pay
  - conduct and
  - anti-bribery and corruption

The focus on ESG is not going to diminish any time soon. That was clear even before the current situation, thanks to global environmental targets, national and European legislation, increasing social pressure and the expectations of employees, investors, customers and other stakeholders.

Arguably, climate change and sustainability currently dominate ESG focus. Retail, as an industry based on consumption, faces criticism in these areas; with concerns arising around packaging, waste, product sourcing, and logistics (such as last-mile delivery). Also, as retail is still predominantly bricks and mortar based, the retail industry cannot escape the significant impact that buildings have on the environment. Buildings are naturally energy intensive; from the products used in construction to the utilities used within them and the waste produced by their occupiers.

However, we are increasingly seeing the impact of the social elements too. Whilst technology has changed how some of us shop, part of the attraction of shopping is the inherent human need to congregate and to share experiences. For many people, shopping is a social event and the repurposing of obsolete retail premises is driven by a need to make spaces where people want to be.

In terms of governance; retail employs a significant workforce, protected by many statutory rights such as the minimum wage and working hours regulations. Compliance with recent governance relating to the closure of non-essential stores and the need to observe social distancing in stores and in warehouses has had a well-publicised and devastating impact on most areas of the retail sector.

It is clear that retail is significantly touched by all areas of ESG. So how do these considerations play out in the market? Just as there is no single definition for ESG, responsible investing means different things to different people and different parties have different levels of commitment to ESG. Few can, however, afford to avoid all engagement with ESG.

Customers are increasingly conscious of issues that fall under the umbrella of ESG and companies that fall short of the standards expected can be exposed swiftly on social media, causing damage to brands' reputations. This means that not only are retail occupiers more conscious of ESG but that they expect their Landlords and the premises that they occupy to address this too.

Many companies recognise that ESG is of itself positive. They include ESG considerations in their investment criteria and asset management strategies because they see the inherent benefit of taking steps to address ESG. There are also those that invest in green buildings or follow ESG principles not because it is "nice to have" or the "right thing to do", but because they recognise the business imperatives, for doing so. They are aware that buildings that are efficient, healthy and green certified are seen as more attractive; which they hope will lead to better quality occupiers, higher property values, greater tenant attraction and retention and improved returns. They understand that if they buy an inefficient building, they will struggle to let or sell it in 10 years, without significant investment in the interim. Or, as is increasingly common, they are seeking funding and the lenders require specific ESG commitments.

As legal advisors, we are seeing many of our clients:

- Insisting on “green clauses” in all their retail leases;

- Engaging in community consultation before deciding on the design and use of a development;

- (As investors, asset managers and funders) incorporating ESG criteria into their procurement processes and investment assessments. These criteria are not just environmental, but may also address how their suppliers treat their own employees and customers;

- Taking steps to ensure new developments or acquisitions satisfy specific environmental thresholds and setting out programmes to retrofit older buildings to make them more energy efficient; and

- Repurposing suitable existing retail sites to make them more sustainable, fit for purpose and attractive to the local communities.

Whatever a company’s motivations, the increasingly common view is that failing to address ESG can damage a business, financially but also reputationally. Those involved in the retail and property industries must give more than lip service to ESG criteria because customers, consumers, occupiers, investors and ultimately therefore, funders are increasingly focused upon them. The impact of COVID-19 makes it likely that those pressures will be even more marked when the industry has had time to reflect on lessons it has learnt and we arrive at the new “normal”.

For further information please contact

Anastasia Klein
Partner
T: 020 3465 4347
E: aklein@maplesteesdale.co.uk