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# ESG – is it still a case of “Who Cares Wins”

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*At a recent Environmental Social Governance (ESG) focused webinar hosted by my firm, Maples Teesdale, we asked three industry experts, Sophie Chick (Head of World Research at Savills), Vicky Cotton (ESG Director at Workman) and Malcolm Hanna (Sustainability Manager at LGIM) the following question, "If you could focus solely on one element of ESG for the next 3 years what would that be?". The resounding response was net zero, but all three also acknowledged that we have work to do on the S of ESG too.*

The response of the speakers is perhaps unsurprising. Climate change is arguably the biggest issue facing every industry, and real estate is no exception. In fact, the figures around net zero and the built environment are alarming. The real estate industry globally (and in the UK) accounts for approximately 40% of all carbon emissions. Those emissions continue to rise. Despite much optimism about the reduction in emissions we have experienced during lockdown, statistics show that even if these reduced levels continued until the net zero target date of 2050, we would still not be carbon neutral!

Global attitudes to climate change vary hugely. Countries in Asia, Africa and South America are not yet on board and parts of the US are going backwards but this is not the case in the UK and Europe. Last year, the UK was the first national government to declare a Climate Emergency, with the EU following suit swiftly afterwards.

It is clear that the focus on ESG is not going to diminish any time soon, thanks to national and global environmental targets and legislation, and evolving consumer expectations. Other factors contributing to the rise of ESG's profile include increased social awareness and large-scale population focus on issues such as waste plastics and socio-economic inequality, as well as widely publicised demonstrations and protests on these subjects. Whilst some feared that the current pandemic might have diverted people's attention away from ESG, our speakers felt that COVID-19 is in fact increasing interest. People are also seeing that swift action can be taken in times of crisis, with the hope that once the current pandemic has passed, such decisive action could be directed to climate change.

It is inevitable that ESG continues to rise up the agenda of responsible businesses and consumers. But what can businesses actually do to address ESG? There is no "model" ESG policy, as each business will need to make its own assessment based on its own activities and assets. The overwhelming view is that good practice requires companies to embrace an ESG policy that is long term and has net zero both as a foundation and a target. It should not however, be limited to net zero and should also have sustainability at its core; addressing social impact and health and wellbeing. A successful policy would include all stakeholders. Alongside these essential long-term goals, it is equally important for a business to identify its own priorities, which might be more short term and give them the ability to use "quick wins" to demonstrate and experience short-term progress.

The next question to address is why should businesses commit to ESG? At all levels of the real estate industry, there are financial and social imperatives for applying ESG criteria. From investment, financing and acquisition, to valuations and asset management, it is becoming more difficult to ignore ESG. The overall view of our panel was that discussions about ESG require engagement from all stakeholders and should be held at the outset of any transaction or development.

Malcolm Hanna noted a real increase in the last 12-18 months of investors requesting ESG information and wanting to understand the real "nitty gritty" of what investment managers are doing: are they alive to ESG issues, are they taking action, what ESG opportunities are available and how can all of this be measured?

On acquisitions, there is a focus on climate risk, and due diligence around this subject is changing. Carbon liability audits are becoming more usual, as are forward-looking risk assessments, which no longer rely on historic data. Responsible purchasers are putting ESG plans in place at the outset of an acquisition.

In terms of valuations, whilst we are not yet seeing people paying a premium for "green" buildings, assets that have, or are likely to have, issues complying with environmental requirements in the future are being impacted on value even now. As Sophie Chick succinctly expressed it, "brown discount is more prevalent than a green premium", but both are likely to become more significant as we approach 2050.

At Maples Teesdale, we are seeing ESG criteria incorporated in procurement processes and investment assessments. Investors are looking at the whole lifecycle of a building. For new developments, the entire supply chain, materials and methods of working should be considered, as should the social impact of the asset. For existing buildings, questions around retro-fitting and "brown discounts" are key to ESG because, as our speaker Vicky Cotton mentioned, for existing buildings, "2050 is only one big refurbishment away". We are increasingly advising clients who want to retro-fit or repurpose their existing assets (often vacant retail space) or acquire assets with potential for repurposing, to make them more sustainable not just environmentally but also socially and to make them more attractive to local communities for the long-term.

At an asset management level, occupiers pose the biggest challenge and this challenge varies depending on the type of asset and the occupier. Engagement with occupiers is however, key because without whole asset engagement, net zero is simply not achievable. It is essential for

owners to try to understand an occupier's goals and aspirations, as well as to explaining the owner's own goals and aspirations. Better and clearer communication is key to this. We as lawyers increasingly see green clauses and data sharing provisions in leases. It is also becoming increasingly common to see targets and performance indicators linked to ESG criteria in asset managers' and facilities managers' contracts..

This engagement and cooperation between owners and occupiers may create incentives to reward tenants for "good" ESG behaviour. What form that would take is currently unclear but it might include rent rebates or reductions, landlords offering investigative or audit work to occupiers to understand the possibilities within an asset, or data sharing.

Whilst there are well-established ways to monitor energy and collect consumption data, there are clear difficulties in monitoring social impact and there is no standardised form of measuring this or collecting relevant data. Ideas such as health and wellbeing surveys for occupiers and engagement with the local community at all stages of a building's life cycle are becoming more common, and data collected from sources such as mobile phones can allow targeted use of resources. Innovations in new plant and equipment and the use of renewable energy and offsite manufacturing of buildings will also help, but even now are often priced out of a development or removed because they are not required by planners or building regulations. Whilst advances in PropTech may assist with this, in many cases the technology already exists. We just need to develop new ways of using tech that already exists and data that is already available. For now, our speakers shared the view that we need to get on with things that we know we can do, not wait for new technology to come along.

Overall, whatever happens, ESG is not going away.  2050 may feel like a long time in the future, but the message is that we need to start making progress now. We cannot continue just doing the same and hoping that that will be enough.

If you would like to listen to a recording of the whole discussion, please click on the link below.

https://soundcloud.com/maples-teesdale/esg-webinar-is-it-still-a-case-of-who-cares-wins