

The rise and rise of ESG

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November's COP26 has reinforced the focus on environmental issues across all sectors and at all levels, from businesses to consumers, investors and lenders. As a result, ESG is at the top of the agenda for many, and the Real Estate sector is no exception. Maples Teesdale recently commented on the demand for eco-friendly workplaces, which was a key theme at Bisnow's 'London State of the Market' event. Rohan Campbell moderated one of the event's panels entitled ['The Future Is Now: London's Path to Healthy, Green Buildings'](#), which saw a panel of market leaders: Penny Goodall-Quraishi, International WELL Building Institute; James Stevens, Aviva; Shiraz Jiwa, The Valesco Group; Bradley Baker, CO-RE; Ivan Harbour, RSHP; and Adrian Gray, HDR, discussing the primary themes of ESG investment.

As recently commented by Maples Teesdale, occupiers are increasingly seeking spaces that 'meet the demand for eco-friendly workplaces that fit companies' sustainability criteria.' This was echoed by Shiraz Jiwa, during the recent panel who stated that investors must look through the 'lens of the tenant' while considering where to invest. Be it better ventilation in buildings or as Bradley Baker suggested 'terraces to be used as boardrooms, weather permitting!' occupiers not only hope for but now often expect a certain 'greener' standard. The panel emphasised the need to reinforce investors' focus on ESG, the benefits of which could be significant. Notably on this issue a recent Knight Frank study on the impact of BREEAM ratings on London office rent found that an 'Outstanding' rating could lead to a 7.5% rent uplift compared with an 'Excellent' rating and as Shiraz Jiwa noted, strong ESG credentials are likely to result in higher retention rates amongst occupiers

One of the most interesting topics raised by the panel was the need to future-proof buildings. James Stevens noted that it is now essential for investors to be able to make this 'transition in the economy [or run the risk] of becoming obsolete.' As Adrian Gray recognised the amount of carbon that goes into a new development runs to the millions of tons! Therefore, we should perhaps be renewing focus on retro-fitting buildings. However, in order to do this successfully, we need to ensure the good 'bones of a building' and ensure we build not just for thirty years' time but a hundred years! (Ivan Harbour). This will have the added benefit of protecting investors' 'exit strategies', which, as Shiraz Jiwa noted is a key point for investors to consider. If environmental issues are important now, they will become critical by the expiry of the usual five-to-ten-year financing term and are likely to directly impact the value and liquidity of the investment.

However, one of the key challenges of ensuring sustainability credentials, both during the lifetime of a loan and then during the exit is transparency and accountability. The media is full of reports of 'greenwashing', where organisations or products have overstated or inflated their green credentials. Organisations and product providers are seen as focusing more on looking the part than actually becoming the part. However, as Penny Goodall-Quarashi noted, the Real Estate Sector is likely to be pushed by regulation, the beginnings of which have already been seen by the recent legislation around EPCs and the Treasury's proposed rules which indicate that the government will be actively engaging with the issue of disclose.

Within the Real Estate Finance sector, green loans or sustainability linked loans have tended to include negotiated ESG key performance indicators, and often a margin ratchet down for the borrower if it meets these targets but measuring these has historically proved challenging. The need, as James Stevens commented, is for 'disclosure'. Previously, borrowers have been allowed to self-report, but lenders are becoming more sophisticated in their approach to setting, verifying, and monitoring KPIs in a collaborative manner. As lenders come under increasing pressure from regulators and investors, there is a move in the market to prevent borrowers from advertising the green financing they have obtained and therefore boosting their green credentials, if they fail to meet the set ESG KPIs. This may not be a financial stick, but it is a reputational stick and together with the incentives already being offered may provide a good mix of measures which will help drive a move towards greater transparency in relation to those KPIs.

ESG will, without doubt, continue to be a prominent issue for years to come and it is increasingly a 'snooze you lose' situation with large pots of funds being made available to borrowers with ambitious ESG targets. As such, ESG is likely to become a prerequisite for equity investment and lending in the real estate sector, a thought from the panel which was echoed in a recent EGI article. It was, therefore, great to hear from the panel that key players across the industry are focused on ESG as a key part of the strategies and are ready to meet the challenges ahead.

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