What’s a sustainability standout city?

Using our unique city-focused approach, we identify future-proof cities that we believe will be attractive investments both today and in Tomorrow’s World. We analyse each city’s ‘DNA’ in light of a number of global megatrends. Cities with ‘sustainable standout’ DNA demonstrate a resilience to the potential impacts of climate change and are well positioned to capitalise upon the opportunities presented by shifting to a low carbon economy. We have identified these cities by using several assessment factors, such as climate change vulnerability scores, the concentration of voluntary sustainability certifications (e.g. BREEAM or LEED), the air quality, local legislation, and which have electricity grids with a low carbon intensity.

Find out more about our cities DNA analysis at threalestate.com/cities
Look beyond the green for value

Sustainability – what does the word make you think of? Put this question to many people and they are likely to fire back terms like carbon reduction, energy efficiency, greenhouse gases, solar panels and recycling. In short, anything that conjures up an image of environmental friendliness. But the over-riding message that jumps out from this year’s PERE report is that the conversation around sustainability is considerably wider. The ‘s’ – social – in ESG is firmly part of the equation in the world of private real estate investing.

For there is a rapidly growing realization among the savviest investors and managers that responsible investing involves the physical assets they own and manage not only meeting a list of green criteria, but having a meaningful impact on society, on the health and well-being of their tenants and occupiers, and helping create urban neighborhoods that will thrive and remain relevant in the long term. An altogether more holistic, “human-centric” approach to sustainability.

To some this might sound a little bit too touchy-feely to be a serious investment discussion point, but the voices in the pages that follow reflect a serious commitment to social and economic impact investing. Well intentioned though it may be, returns need to get delivered and it can be rather more challenging to demonstrate a direct link between socially driven initiatives and positive investment outcomes. But look at it this way – it is simply best practice to keep the end-user happy in your buildings. By capitalizing real estate that people want to live, work and play in, leases are more likely to get renewed, tenancy lengths to increase and rental income to grow. Desirability means less chance of obsolescence. And there is little doubt that occupiers are more discerning than ever about what they want from real estate space. So investors take note; community and tenant engagement is likely to be making a difference to your bottom line.

But don’t take your eye off the ‘green stuff.’ The World Green Buildings Council has set a target – all new buildings must be net-zero carbon by 2030 and all buildings by 2050. So it is good news that GRESB has just reported a 4.9 percent reduction in the sector’s greenhouse gas emissions year-on-year, the highest in six years, and a 2.5 percent average reduction in energy consumption in 2018. Progress is being evidenced, but there is always more to do. The race to reach the summit of sustainability continues.

Enjoy the report,

Helen Lewer
Special Projects Editor
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Gaw Capital Partners

Gaw Capital Partners is a real estate private equity firm and has raised five commingled funds targeting the Greater China and APAC regions since 2005. The firm also manages value-add / opportunistic funds in Vietnam and the US, a Pan-Asia hospitality fund, a European hospitality fund, and also provides services for separate account direct investments globally. Gaw Capital currently commands assets of over US$ 18 billion under management.
**Leader board**

Among 2018’s sustainability sector leaders are Bentall Kennedy, Aberdeen Standard Investments, PGIM Real Estate, Lendlease, Greystar and JPMorgan Asset Management

### EUROPE

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* denotes global as well as regional sector leader
At Invesco, we’re dedicated to delivering an investment experience that helps you get more out of life.

For us, at Invesco Real Estate, a crucial component of this is being a sustainable investor, which is engrained in our business philosophy – for the benefit of our clients, our tenants, our business partners and our staff.

We are proud to have our efforts recognised in 2017, which includes:
- Being awarded a Global and regional GRESB* Sector Leader for three strategies
- Achieving 1st in their respective peer GRESB group for three strategies
- Green Star rated for six of our strategies by GRESB
- Green Building Certifications (including LEED, BREEAM, HQE, IREM CSP, NGBS) in the US and Europe
- ENERGY STAR® certification across offices and multifamily in the US
- 25% of properties are CASBEE* S- or A-Ranked in Japan
- An average NABERS* score of 4.6 Stars for properties in Australia

This means that sustainability is not just a badge-wearing exercise at Invesco Real Estate:
- We share best practise across our business
- The majority of our assets have a sustainability action plan
- We work closely with key stakeholders to deliver on this global plan

Invesco Real Estate is proud to be a sustainable investment manager.

www.invesco.com
Another year, another step up

Participation in GRESB’s benchmark has increased yet again in 2018 as sustainability performance also continues to improve across the sector.

The private real estate sector’s efforts to up the ante in its commitment to sustainability and responsible investing are paying off, according to this year’s GRESB results. Firms are reporting more asset-level data than ever, and transparency and measurement of ESG has increased again. The 79,000 assets included in the benchmark and 903 property companies, REITs, developers and private funds represent an increase of 2.5 percent and just over 6 percent, respectively, from 2017. A total of 690 private entities participated this year, up from 646 in 2017. Yet again Europe wins the race as the most sustainability focused region, although all regions register an uptick in participation. However, the overall rate of participation (which includes listed entities) has slowed: a 6 percent increase compared with 12 percent in 2017.

Trending upward

Total participation rate increases again from 850 in 2017 to 903 this year.
Putting ESG to Work for All Our Stakeholders.

At PGIM Real Estate, we believe that doing the right thing for our clients, our people and partners, our environment and communities drives better results for all stakeholders.

We’re committed to responsible, sustainable real estate investing and management. We seek to deliver enhanced, risk-adjusted returns for investors, become a landlord of choice, and continue to practice good global citizenship.

Learn more about our environmental, social and governance initiatives at pgimrealestate.com and prudential.com/purpose

A+ STRATEGY & GOVERNANCE, A PROPERTY*
AWARDED BY PRINCIPLES FOR RESPONSIBLE INVESTMENT

AMONG WORLD’S MOST ETHICAL COMPANIES**
ETHISHERE

25 GRESB GREEN STAR AWARDS IN 3 YEARS
AWARDED BY GRESB

79,764 EMPLOYEE VOLUNTEER HOURS FOR LOCAL COMMUNITIES***
ACROSS THE U.S.
Europe is the winner

European participation is well ahead of North America and Asia, although non-listed response rate is up across the regions.

GRESB results in numbers

- Increase in participants this year from last: 6%
- Countries represented: 64
- Continents represented: 6
- Public entities included: 213
- Total asset value of the participating entities: $3.5trn
- Assets included: 2018 - 79,000, 2017 - 77,000

Source: GRESB
Waking up to resilience
Chris Pyke, research officer for the US Green Building Council, summarizes GRESB’s first global look at resilience across the sector

Global weather-related disasters cost a record $344 billion in 2017, including $212 billion in uninsured losses. This new high-water mark reflects a combination of social and environmental factors that put more people and property at risk. Property investors are particularly exposed to these issues, as the value of long-term, illiquid assets is intrinsically linked to their location and geographic circumstances.

High-profile shocks have helped raise awareness among investors, and new tools have given companies guidance on how to assess and communicate risks. In 2017, the Financial Stability Board’s Task Force for Climate-related Financial Disclosure (TCFD) provided recommendations for resilience-related reporting, motivating GRESB to add a Resilience Module to its Real Estate Assessment. The module adds eight new resilience-related indicators. In its first year, 121 property companies reported on these indicators, providing a snapshot of management action in North America, Europe, Asia and Australia/New Zealand.

Responses can be summarized across four broad categories: governance, risk management, business strategy and performance metrics. The governance of resilience starts with leadership: 90 percent of module participants have a specific senior employee with responsibility for resilience. These leaders are often charged with conducting or co-ordinating asset- or organizational-level risk assessments. More than 84 percent of entities report periodically evaluating the vulnerability of assets and 85 percent assess overall business operations. More than 80 percent described business objectives and have taken specific actions to mitigate risks and increase resilience.

Responses to individual indicators are important. However, effective management requires co-ordination of these elements simultaneously. Analysis across indicators shows significant differences between respondents. The top quartile of respondents report an average of 81 percent of resilience elements. The bottom quartile report an average of 22 percent of elements with high variance among responses. This suggests that many resilience-related practices are widespread, but there is significant variation across the market, even in this self-selected group of GRESB participants.

Good progress, but more needed
Property companies are beginning to pay attention to resilience. Most respondents have established clear internal leadership; conducted social and environmental risk assessments; begun implementing strategies during development, operations and acquisition; and some are collecting data about shocks, stressors, impacts and near-miss events.

The quality and impact of these actions remain impossible to evaluate. An analyst can see that these management systems and actions exist, but it is not yet possible to evaluate if they work as intended. This situation will change as disclosure about resilience-related management and practice is combined with outcome measures, such as loss rates, asset value and operating income.

These efforts are not surprising given rising interest from institutional investors. Moving forward, market participants can expect even greater focus on resilience from investors, government and tenants. Some companies are already turning this interest into competitive advantage by offering resilience as an amenity at certain properties, such as advertising features like back-up power or flood-resistant designs. Other companies are conducting comprehensive risk assessments and applying this information to inform plans for capital investment and operations.

The results also show that resilience-related practices vary significantly between property companies. This means investors need to ask more questions about how their investments are identifying potential risks and integrating these considerations into business strategies. Over time, the focus of this engagement is likely to shift from qualitative statements toward more objective and quantitative measurements. Over the next several years, this is likely to include greater applications of geospatial risk models and the use of third-party certifications and ratings. The GRESB Resilience Module and core assessments will evolve to drive and support these important steps to protect shareholder value.

Resilient leadership
How firms are measuring up on resiliency indicators

<table>
<thead>
<tr>
<th>Indicator</th>
<th>Score</th>
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<tbody>
<tr>
<td>Senior employee responsible for resilience issues</td>
<td>81</td>
</tr>
<tr>
<td>Cross-departmental team for resilience activities</td>
<td>79</td>
</tr>
<tr>
<td>Actively identify and engage potentially impacted stakeholders</td>
<td>78</td>
</tr>
<tr>
<td>Periodically assess vulnerability of assets</td>
<td>78</td>
</tr>
<tr>
<td>Periodically assess vulnerability of business operations</td>
<td>78</td>
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<tr>
<td>Objectives and strategies to promote resilience</td>
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<td>Specific actions to promote resilience</td>
<td>78</td>
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<tr>
<td>Response to illustrative disruptive events or near misses</td>
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Source: GRESB
Beyond bricks and mortar
Ivanhoé Cambridge’s Michèle Meier explains why private real estate owners’ contribution to creating resilient cities does not stop at the front door of their buildings

Protecting property in the world’s most vulnerable cities against the worst ravages of natural disasters and climate change is often how ‘resiliency’ is defined in the real estate context. But to see this increasingly important subset of sustainable investing through such a narrow lens is shortsighted. The 11th of the UN Sustainable Development Goals makes it clear the urgency with which the world must respond to the challenges of rapid urbanization through efficient urban planning by creating cities that are “inclusive, safe, resilient and sustainable.” Michèle Meier, vice-president of communications, corporate marketing, CSR and international affairs at global investment firm Ivanhoé Cambridge explains why the private real estate sector is in pole position to make a difference and drive this forward.

**PERE**: What is a ‘resilient city’?
**Michèle Meier**: Ensuring buildings are flood and earthquake safe is a core part of developing resilient cities, but for our cities to be truly resilient, a more holistic approach is required. Resiliency is not just about making sure cities survive; they must also thrive. This means making them attractive places for people to live, work and play in the long term. People want to be confident their homes won’t get damaged in a hurricane, but they also want to live in cities with green space, good transport links and many other amenities. These features make a city somewhere that people actively choose to live. This is how we define ‘resilient cities’ and we see a definite shift in the market to adopting this mindset.

**PERE**: Tell us more about Ivanhoé Cambridge’s approach to resiliency.
**MM**: Our approach is profoundly human-centric. We want to develop and invest in ambitious projects that enhance the comfort, quality and safety of occupants. That involves minimizing the environmental footprint across our portfolio, but we are also committed to making a positive impact on the wider community. Our ethos is that we have a responsibility beyond the walls of a building. It’s about how a particular property is helping to shape the neighborhood and landscape. To achieve that, it’s important to have a 360-degree view of the impact of our investments and how they score against ESG criteria. This involves reviewing risks relating to climate change. We look, for example, at the energy intensity of a development and the impact on our carbon reduction objectives. And social factors are equally important – health and safety, reputational and ethical issues.

**PERE**: Why is adopting this wider approach to creating resilient cities important for the private real estate sector?
**MM**: The value of our properties depends on the wider environment in which they are located. As investors, we have a responsibility to ensure we capitalize and build projects that meaningfully contribute to the wellbeing of their occupants. The onus is on the real estate sector to carefully select where we develop urban projects that will allow cities to survive and thrive in the future. Property owners that see resiliency in this light and appreciate how critical it is to keep the end-user happy will have a true competitive advantage. This is the key to long-term value creation; if occupants, whether it’s office workers, retailers or hotel guests, are satisfied with a building and its surrounding space, then they are going to want to stay there. That creates resilient properties and cities, and ultimately that is good for owners.
These initiatives are not all being driven from within the sector itself. Rather we are responding to what our stakeholders are demanding from us. Today’s occupiers have greater expectations than those of the past and are putting more pressure on the sector to meet their needs. Office tenants, for instance, expect ample and flexible space, clean air, good lighting and amenities. Many cycle to work, so they want safe areas to store their bicycles and they want access to showers; their needs go beyond a desk, chair and telephone. Catering to how people want to live, work and play is a more serious and complex business now. Every stakeholder group is interested in resiliency and as an industry we must listen and respond. To repeat my earlier point, it really is about adopting a more human-centric approach to real estate that goes beyond square meters and bricks and mortar.

**PERE:** Is the industry currently showing enough commitment to resiliency?

**MM:** With more than 30 percent of greenhouse gas emissions coming from the built environment, our industry has no choice but to take action and put strategies in place to reduce its carbon footprint. Overall, the real estate sector has made, and continues to make, huge progress and many investment managers and investors, big and small, are fully committed to doing more. And thanks to initiatives like GRESB, we can expect further progress in the coming years. There are many ways we can help to maximize resilience: strive for higher standards, seek certifications, reduce energy consumption. But this really is the obvious stuff. There is more to do in terms of the industry as a whole acknowledging its responsibility to positively contribute to the communities in which we do business.

**PERE:** Are there specific obstacles that make it difficult to advance the wider definition of resilient cities?

**MM:** There’s evidence aplenty that sustainable investing and adherence to ESG criteria enhance long-term investment performance. But the challenge with sustainable initiatives and resilient city projects is that value is created over an extended period, yet our returns are measured yearly. Value is not necessarily visible in the short term. This can make it difficult to get these projects financed because time is required to gather performance data over several years to show a positive and direct correlation between resiliency and performance. We see this tension regularly in the market. Data is now a critical tool in empowering managers and investors to make a positive case for these projects and garnering support for them. So it’s a good sign that the industry is getting better and more efficient at gathering, analyzing and measuring data.

There are positive signs that lenders are beginning to embrace these projects too. Ivanhoé Cambridge itself was a recent beneficiary receiving Europe’s first green-labelled commercial real estate loan to finance the development of the DUO towers in Paris with our partners, Natixis Assurances.

Another challenge is that investing in resilient city projects often means engaging in some sort of innovation process and budgets for this can often be difficult to justify if stakeholders can’t see upfront the direct performance benefit to them. The question usually is; ‘how much does it cost?’ The response should often be; ‘how much does it cost not to do it?’ Overall, I’m optimistic the market is moving in the right direction in committing to the development of resilient cities.

**Case study**

**Transforming downtown Toronto**

In Spring 2017, the construction of Toronto’s CIBC SQUARE got underway. Billed as an iconic project that will alter the skyline of Canada’s biggest city, it is the result of 10 years of meticulous planning, dialogue and collaboration with the local community, and the embodiment of Ivanhoé Cambridge’s holistic approach to real estate development in major hub cities. “We hope it will set a new standard in office building quality and be a good example that it’s not just about the building itself, but how that building contributes positively to shaping a city’s future and fostering an environment that supports the wellbeing of occupants,” says Ivanhoé Cambridge’s Michèle Meier.

**Location:** Toronto, Canada  
**Concept developer:** Ivanhoé Cambridge  
**Investors:** Ivanhoé Cambridge and Hines  
**Size:** 2.9 million square feet  
**Anchor tenant:** CIBC  
**Key features:** two elegant glass buildings; one-acre elevated green park; integrated transport links including a GO Bus Commuter Terminal and subway and rail corridor; cutting-edge office and collaborative spaces; more than 1,000 bicycle parking spaces and electric vehicle charging stations  
**Projected certification labels / designations:** Wired-Score Pre-Certified Platinum and pursuing both LEED® Platinum Core & Shell and Delos WELL Building Standard™  
**Completion date:** stage 1 in 2020; stage 2 in 2023
Unpacking the financials behind sustainability

Although some progress has been made, quantifying the impact of green practice on real estate investments remains difficult to do. By Evelyn Lee

How does sustainability translate into actual performance? The answer is not always clear-cut. Numbers relating to cost savings are not difficult to find. For example, after buying 475 Sansome in 2012, Toronto-based real estate investment advisor Bentall Kennedy implemented a waste diversion, energy and water conservation measures and a tenant engagement program at the San Francisco office building. The firm has disclosed that since then, the property’s energy costs have fallen – declining by $77,000 in 2017 alone – and led to an increase in net operating income of $418,000 over the 2012-17 period.

But calculating the overall financial impact of sustainability measures on the return on a property investment is far from straightforward. “A lot of times, there’s this desire to say, there’s this direct line from sustainability to this performance, and there’s a lot of factors that go into asset performance,” says Molly Bordonaro, managing partner at Portland, Oregon-based real estate investment manager Gerding Edlen. “We are absolutely certain that everything we do around sustainability drives value into the asset, in terms of how we’re able to market, lease and generate higher rents.”

However, the location, quality and size of the property also are important factors. Bordonaro therefore speaks about the impact of sustainability on the firm’s assets in broader terms. “We certainly position our properties as different in the marketplace,” she says. “We tend to be able to lease our buildings faster and we tend to be able to drive higher value in terms of rents or net operating income.”

The most significant impact on value, however, is Gerding Edlen’s high tenant retention rate, where approximately 60-65 percent of the tenants in their apartment properties renew their leases per year, compared with the market average of approximately 45 percent.

“The market is yet to adopt a mature and transparent approach to monetizing and valuing sustainability benefits, although a positive shift in this direction is becoming more evident,” researchers Surabhi Sheth and Saurabh Mahajan wrote in a 2014 report from the Deloitte Center for Financial Services. However, “there is increasingly clear evidence that buildings (re)designed with green features will depreciate less quickly than others and will be more likely to meet the growing demand of a more discerning occupier and investor market,” the authors said. In fact, in markets where green buildings are common, properties that lack sustainability features often tend to have a “brown discount,” implying a potentially lower rental rate or sale price than the market average, the authors said.

Indeed, real estate owners need to take sustainability into account in order to keep their properties from becoming obsolete, says John D’Angelo, managing director at Deloitte. “At some level, it has to do with assets continuing to be relevant or continuing to hold value in a marketplace. When it first became a term, it was more of a touchy-feely, feel-good thing and now it’s just hard-nosed asset relevance.”

David Antonelli, executive vice-president at Bentall Kennedy and portfolio manager of Multi-Employer Property Trust, the company’s open-end real estate fund, says that with tenants demanding more from buildings they occupy, properties with environmental and wellness features will tend to be more profitable. “Sustainability should be considered for its merits as a revenue generator, given its importance in the evaluations that present and prospective tenants are making about where they want to locate.”
to reside,” says Antonelli. Meanwhile, operating cost savings and enhanced revenue make sustainable buildings 8-10 percent more valuable than other properties, according to Antonelli.

One common misconception about the financial impact of sustainability deals with cost savings, when in reality the benefits are more far-reaching. Aside from cost savings, “sustainability investments result in even broader payback in the form of higher rental income and occupancy, improved valuation, easier and lower-cost financing, lower operating expenses, property tax rebates and discounts on insurance premiums,” Sheth and Mahajan wrote in the Deloitte report.

Moreover, cost savings have less of an impact on overall returns than the “top line benefits” of higher rental and occupancy rates and higher property values over time, they noted. Meanwhile, the higher loan-to-value ratios of loans available to LEED-certified buildings have the most significant impact on the post-retrofit internal rate of return on the overall building investment.

After an existing office building is retrofitted with measures such as energy and water efficiency and waste reduction, the IRR of an overall building investment increases by 98 to 220 basis points post-retrofit, according to the report.

Slow adoption
Another misconception is that sustainable practices cost more than standard improvements. “Research demonstrates there isn’t a significant incremental cost of greening an existing building compared to the cost of mending a building exterior,” Sheth and Mahajan wrote. More awareness and education on sustainability practices has also helped to reduce the costs of green certification. “To a large extent, the hesitance toward sustainability adoption can be attributed to the lack of awareness about returns versus costs.”

Overall, many real estate managers still have a ways to go when it comes to adopting sustainability measures. “If you set the bar as who’s best in class, who are top quartile, it’s 20 percent maybe by AUM that really have their act together,” says D’Angelo. “They’ve got expertise, there’s somebody who’s thinking about it every month.”

He points to the annual GRESB real estate assessment survey, which assesses the sustainability performance of real estate assets globally, and estimates up to half of managers “scramble” every year to compile the data needed to complete the survey, while the remainder simply don’t even have the data.

“If you’re doing right, it shouldn’t be a scramble,” he says. “The data should be at your fingertips because you’re using it as part of your day-in and day-out management process.”

Yet another misconception is that sustainability measures are incompatible with closed-end funds, since a manager would not be able to see the upside of that investment, and therefore generate an appropriate return, within the life of the fund.

“We see results very early on,” says Bordonaro, whose own fund manages closed-end funds. Indeed, Gerding Edlen saw cost savings of $11,700 in 2017 from a co-generation system installed at The Eddy, one of its residential mixed-use properties, according to a 2017 report on the firm’s Green Cities II Fund. The asset was just completed in 2016.

And not all sustainability measures involve expensive upfront costs. From 2016-17, Gerding Edlen partnered with a local utility company and three other organizations to launch a pilot “Eco-Concierge” program at one of its apartment properties in Chicago. This included a web-based gamification platform used by tenants to earn points by logging their sustainable actions and consequently be eligible for prizes. The sustainable actions connected to the game resulted in the equivalent of average utility bill savings of $70 per player, while the program was implemented at the property at no cost to the firm.

Dan Winters, GRESB head of America, agrees the impact generated by sustainability measures can be seen far more quickly than many people assume. “Marginal investments to reduce operating expenses are immediately reflected in NOI, while achieving an Energy Star or LEED rating signals asset quality at key financial moments of truth – leasing and sale transactions.”

For example, at a 6 percent cap rate, a property acquired for a value-add fund can gain nearly $17 per square foot in value for every $1 per square foot in operating expense savings, according to Winters. He expects as more real estate managers incorporate green practices, not only will the environmental performance of the firms improve over time, so will their financial performance.

In real estate, water and energy will be “some of the biggest spend on a regular basis on an asset level,” says D’Angelo. “If you can move the dial on environmental performance, there’s going to be a return.”

Bordonaro: sees higher tenant retention rate than competitors
Zero is the magic number

TH Real Estate’s Abigail Dean talks about the drive toward a zero-carbon economy and private real estate’s starring role

Ratification of the Paris Accord in 2016 created the path toward a global low carbon economy, and the real estate sector is expected to contribute to the project. The World Green Buildings Council has stated that all new buildings must be ‘net zero carbon’ by 2030 and all buildings by 2050. TH Real Estate’s global head of sustainability, Abigail Dean, considers the progress the sector is making to deliver this ambitious goal in the timeframe set.

Pere: Why is the zero-carbon economy significant for private real estate asset managers and owners?

AD: Regulatory changes are pushing us all down the zero carbon path. In Europe alone, we’re anticipating changes to building regulations, the wider rollout of the Minimum Energy Efficiency Standards and the introduction of carbon taxes. Public awareness of the issues is growing and businesses are expected to demonstrate environmentally friendly policies and practices. Swimming against this tide can cause reputational damage. It’s not a surprise that investors and occupiers are making sustainability a key factor in decision-making. Asset managers must respond and establish a clear pathway toward ‘net zero carbon’ in order to future proof the value of their buildings: we can safely assume property that is not ‘net zero carbon’ will become less liquid and less attractive to tenants. They’ll start to lose value and ultimately become obsolete. This is why it matters.

Pere: How is TH Real Estate delivering on this ‘zero-carbon’ building commitment?

AD: We’ve publicly committed to reducing the energy intensity of our portfolio by 30 percent by 2030, which puts us well on the way to zero carbon. It’s important to establish specific targets for each property in the portfolio. For example, we’ve structured our portfolio into tiers and identified the buildings that require focus. And we’re trialing technologies in these buildings to ensure we achieve rapid carbon reductions. But our sustainability strategy has been in place for over a decade now, so we’ve already seen results in terms of reduced energy consumption and carbon footprint. Renewable energy is another important focus for us and we’re rolling out onsite renewables such as photovoltaics wherever possible.

Pere: To what extent are institutional investors driving the move to zero-carbon buildings?

AD: The articulacy of investors around sustainable issues has improved in the last decade. GRESB’s sustainability benchmark has transformed their attitude toward sustainability by fostering a better sense of its importance in the built environment and an understanding of the sustainable performance of one fund versus another. We’ve definitely faced increased investor pressure to report progress in the area. Dutch, Scandinavian and Australian investors are particularly proactive, setting ambitious goals to reduce emissions across their portfolios and they’re engaging with...
their asset managers around the proportion of energy generated from renewable sources. They want evidence that buildings are moving in the right direction toward zero carbon. Large institutional investors are able to set the tone, and while there’s less focus on sustainability in investment markets that are more fragmented and with smaller investors, it is generally becoming a factor in their interaction with us and a feature in allocation decision-making. They’re taking a long-term view and believe it’s important to the future performance of investments.

**PERE: Are there specific challenges to achieving the ‘zero-carbon’ target?**

**AD:** ‘Net zero carbon’ is not precisely defined for real estate. This must be addressed in legislation. There is a working definition; a building that is energy efficient and uses renewable sources, but it’s not clear to what extent that energy should be supplied from onsite renewables, near-site renewables or from a renewable grid.

It’s also difficult for the market to identify which buildings are more energy efficient than others and to isolate the exact element within a building that is improving sustainable performance. A compare and contrast exercise is not easy. The Energy Performance Certificate in the UK, for example, actually gives very little indication of operational energy efficiency. What’s required is an operational energy efficiency rating system in Europe. TH Real Estate is part of a group called Design for Performance that is seeking to bring the Australian NABERS-style operational rating system to the UK.

But sustainability is part of market expectation now and it shouldn’t be a challenge to justify the need to focus on it as a matter of importance.

**PERE: How important is tenant engagement?**

**AD:** A significant proportion of our tenants, particularly in the retail space, have their own direct energy contracts, which makes getting visibility of energy consumption and efficiency in tenant spaces more challenging. As asset managers, we need to consider whether to focus our efforts on driving energy efficiency in landlord-controlled spaces, like the general mall space, or how best to engage with tenants to access the information we need and work with them to set the appropriate efficiency targets. We are strengthening our tenant engagement platform to address these issues because we believe it absolutely makes sense to collaborate with them to help them meet their own carbon reduction goals. The industry cannot meet the ‘zero-carbon’ goal unless tenants are on board too.

**PERE: Is utilizing the latest technology and data a critical part of the pathway?**

**AD:** It allows us to optimize energy efficiency and monitor performance more easily. But the challenge for all owners is to keep up with the rapid pace of change and innovation. Buildings not incorporating the latest smart building and energy efficiency technology will risk becoming obsolete in the long term. The sheer volume of data can be overwhelming too, so it’s important to have good systems in place to manage this. Our global energy management platform is a powerful tool that allows us to monitor progress toward meeting targets and identify areas requiring more focus. We’re also looking at systems that offer a view on energy consumption on a real-time basis. For example, we’ll know when equipment is working too hard or not hard enough at specific times, and use that knowledge to shift toward a more energy-focused maintenance regime; so gathering intelligent information to inform the maintenance schedule.

**PERE: How damaging is the US withdrawal from the Paris Accord?**

**AD:** Obviously, the federal government’s position is disappointing, but as soon as the announcement was made, individual states – California, New York, Washington DC – and districts swiftly reaffirmed their own commitments to the Accord. And the development of legislation around energy efficient buildings continues to evolve at the state level. There’s legislation in New York, for instance, around energy labeling and introducing smart meters. The US business community also remains committed to meeting carbon reduction targets.

**“The articulacy of investors around sustainable issues has improved in the last decade”**

**Abigail Dean**

**“The industry cannot meet the ‘zero-carbon’ goal unless tenants are on board too”**

**Abigail Dean**
Setting the target
GRESB scores for 2018 are in and the sector has once again upped its game. Two investors explain why it is critical that performance keeps improving.
Mark Cooper reports

As GRESB reveals the results of its annual benchmark, PERE listens in as the organization’s co-founder and managing director, Sander Paul van Tongeren, talks to investors – Nicole Bradford, portfolio head, responsible investment at Cbus Superannuation Fund in Australia, which has A$3.2 billion of real estate assets under management, and Arjan van Wieren, director of private equity, infrastructure and real estate at Dutch pensions group MN – about how they use GRESB in their portfolios and how they see sustainability reporting and wider ESG considerations evolving in the coming years.

A watchful eye

Sander Paul van Tongeren: GRESB is now in its ninth assessment year and the response rate from the sector has increased again in 2018. The assessment now covers more than 79,000 assets across 64 countries, representing over $3.5 trillion gross asset value. And we’ve seen an increase in the global average GRESB score, which increased to 68, up from 63 in 2017. Furthermore, 78 percent of all entities benchmarked qualify as Green Stars, up from 70 percent in 2017. Of course, this inevitably means that Green Stars are no longer necessarily the main distinguishing factor between managers; rather the GRESB Star rating (from 1 to 5) and the peer groups (same region and same sector) are the more important differentiators.

Arjan van Wieren: It’s good to see the industry adopting GRESB more and more. We also see that the quality of the data improves, and that’s important for us as an investor. Without a GRESB score, we will not invest with a manager.

We’ve set clear goals for ourselves and our managers to improve GRESB scores continuously. This means we have a formal dialogue on certain areas where we think managers can improve. Looking at some of the managers we hire now, however, they’re still working to adopt and integrate better ESG profiles into their processes. We accept that it takes time, but we want to see evidence of performance gradually stepping up.

All our property managers participate in GRESB. We primarily have unlisted investments in the real estate space, and that includes both direct, through our subsidiary Cbus Property, and indirect investments, through our other two pooled investment fund managers. We use GRESB information in several ways. First, it’s a really important tool for engagement with fund managers. And because we can now track trends over time, we can more easily benchmark managers and see where improvements have been made. So, in short, we use GRESB to understand the strengths of each manager and identify where they can improve. What I like is for each manager to set targets, because you don’t manage what you don’t measure.
We also use it for engagement with our beneficiaries. Cbus is the superannuation fund in Australia for the building and construction industry. Our members are working in this sector and on buildings, so it’s great for us to be able to show the impact we’re having. We report GRESB through our integrated annual report, and this year we’re also developing and publishing a corporate responsibility report.

**SPvT:** You referred to the importance of setting targets so that managers have something concrete to aim at. Are there particular themes you focus on, or is it more the whole ESG spectrum and whether managers improve on this?

**NB:** It’s both really. At a high level, we want to see an improvement in the GRESB score and how managers are tracking over time, but we do also focus on specific areas that reflect our broader responsible investment principles and our member base. Climate change is important for us to future proof our assets and the built environment fits naturally into that space. We also focus on health and safety, which is important to our members if they’re working on these building sites. We’ll look at what metrics we can use from GRESB to enhance our conversations with our managers on these topics.

**AvW:** We obviously want to provide for the financial future of our beneficiaries, but also it’s important for us to play a contributing role in helping them live comfortably in the world. We have integrated ESG in our investment process and in the way we select and monitor our partners in the execution of our real estate strategy. On top of that, we focus on three themes within the real estate strategy: affordable housing; energy transition; and the circular economy. For example, we represent beneficiaries in the metal workers industry. It is important for them to have affordable housing when they retire. And we therefore feel it is part of our fiduciary duty to make sure there is sufficient available affordable housing. There is, of course, a financial risk perspective: we focus on climate risks and we’re a signatory of the Paris Pledge and we have set carbon reduction targets. It’s important for us to have a clear strategy on how to deliver these targets.

**NB:** One of our key overarching investment beliefs is that as trustees we can improve long-term returns for our members through active involvement in ESG issues. We think it’s important for all our investments to consider responsible investment and see this as a key strength. There’s a lot of evidence to suggest that a good responsible investment approach enhances risk-adjusted returns. We have experienced this through Cbus Property, delivering substantial returns for our members for over a decade, creating jobs for the industry and developing leading commercial green buildings. Our bottom line is providing a superannuation for our members so they can retire with dignity, if we can also create a positive environment for them to work and then retire in, and for their families and grandchildren, then that’s an added benefit for them too.

**SPvT:** How do you report your ESG performance and overall GRESB score to your clients and stakeholders?
AvW: We report the GRESB outcomes of the total portfolio to our clients and we’re planning to improve it continuously as the quality of data becomes better. It’s important to set clear targets and benchmark what you want to achieve, and also report back on it whether or not you reach the goals set. For each of the managers we work with, we have an extensive ESG questionnaire of which GRESB is a major part of the real estate side. But it is not only GRESB. We also use other ESG criteria that we use for every manager in the monitoring, which we also report on. In addition, we report on SDG exposure and also on the impact of our investments; this is, in our case, for example, the number of households we provide affordable housing to.

NB: We report our overall GRESB score. We want to make sure that we’re able to show progress and demonstrate how our managers are tracking. It’s also important to remember that our focus is in providing a return to our members, and we need to show that ESG initiatives support and help drive those good returns.

Leading the pack

SPvT: Something we’re often asked at GRESB is how Australia can outperform other regions. One reason, I believe, is that there is a drive from both investors and managers. Investors are really leading the way, but also the managers are super competitive, and in general they’ve fully integrated ESG across the organization. In most parts of Europe, I always have the feeling that it is mainly the investors that push for this.

NB: In Australia, the market has been developing green buildings for a long time, particularly in the commercial property space. If you were building a new commercial A-grade premium building and you didn’t build green, you simply wouldn’t be able to secure tenants. As investors this is about future proofing our assets and we’ve just committed our property portfolio to be net zero carbon by 2030. You’re also right about competition. One thing I really love to see is that our fund managers compete both against themselves to improve their GRESB scores, but also against their peers. That’s a really great way to identify areas of improvement and spur them on to do better.

AvW: The institutionalized managers are integrating ESG into their practices, but there’s still a large part of the industry that has not incorporated it yet. So, that’s true, it’s mainly driven by the investors in Europe, but I’m very positive about how managers are evolving, although most of them still have to increase their effort to improve, and it’s imperative that they do because a lot of investors are not willing to accept the lack of an ESG policy or ESG integration.

Continuous adaptation

SPvT: How do you see sustainability in private real estate evolving in the next decade?

NB: There’s a lot of focus on climate change and how to report in line with the recommendations of the Task Force on Climate-related Financial Disclosures (TCFD). Our investment committee just approved a climate change roadmap from a whole portfolio perspective. And that looks across different asset classes. The Paris Agreement and its sustainable development goals have led to a significant rise in responsible investment. Looking a little further forward, we hope to see more carbon-positive buildings.

A significant development globally is the rising importance of human rights; the social component of sustainability. In the real assets space, this encompasses issues such as labor rights and wellness. We’re just about to introduce modern slavery laws in Australia, modeled on what’s happening in the UK. We are working toward how we meet the requirements of that legislation and putting a human rights overlay across our investment portfolio and also how we operate as an organization as well.

We haven’t taken account of all 17 of the UN Sustainable Development Goals (SDG) for our property portfolio. The approach we’ve taken is to identify the goals that are appropriate for our strategy, with a focus on the built environment. That is where we feel we can make the best contribution and create additionality.

AvW: The main trend will be an increased demand to stay on the path of the carbon reduction targets in the Paris Accord. This will require greater focus on the carbon footprint of buildings. Investors will continue to raise the bar in this respect. If managers want to survive in the business, they must evolve. The SDGs will be an important part of investments going forward. We have mapped our portfolio based on where we stand on SDGs and some of our clients have also established clear goals on where they want to stand in a few years time. It means that investors like us must integrate ESG and SDG objectives in all of our portfolios. In the future, the integration of all this thinking will become mainstream. We hope it will become more and more standard practice in the markets. So GRESB is also, for us, a really important force to work with and we hope that it too will continue to evolve. □
Why resilience matters to investors

Resilient communities attract businesses and people, and increase value, writes Caroline Field, resilience practice leader at engineering consultancy MMI-Thornton Tomasetti

Today, we are living in what has been termed a VUCA environment; that is one that is volatile, uncertain, complex and ambiguous. Brexit, technological change, urbanization, climate change and demographic change all present threats to those ill-prepared to manage the impact, but also opportunities for those agile enough to capitalize on them.

The challenge facing real estate investors is how to make decisions to anticipate, adapt, maneuver and change course as needed within a dynamic world; making investment in the right places and at the right time that will continue to deliver value in the future. Resilience is key to delivering this.

The International Standards Organisation defines resilience as “the ability to absorb and adapt in a changing environment.” Essentially, this describes the ability to manage shocks, such as flooding, power outage and continue through disruption in the short term, and to adapt to stresses like climate change, Brexit and other challenges in the longer term. Better resilience allows realization of strategic ambitions through protecting critical resources, creating and sustaining opportunities for enterprise and empowering individuals, communities and places not only to survive but also to thrive.

Resilience yields five main benefits for property owners and managers. First, resilient real estate minimizes business disruption and asset damage. In turn, this reduces costs and keeps you and your tenants and the community in business. Second, resilient cities and communities attract business and people, and this increases the demand for real estate. Third, a resilient organization can gain competitive advantage by being agile enough to avoid risks and seize opportunities before others. Fourth, resilient real estate reduces whole life costs by providing a flexible, adaptive building that is easier to change to meet future needs. The fifth benefit is that a resilient culture and approach facilitates clear, evidence-based decision-making and prioritization of investment, which leads to realization of strategic goals.

Approach to creating resilient real estate

Based on BS67000 – the British Standards Institution guidance for increasing city resilience – a good resilience strategy has a balance of measures that are durable, adaptable, inclusive, integrated and reflective. Durable measures protect and enhance the value of assets. Investing in protective measures should consider risk, cost, benefit and adaptability. Inclusive measures take a strategic human-centered approach, including stakeholder participation – building users and the wider community – in your development. This provides a shared ownership and maximizes value delivery. Think about how your real estate can help deliver community value by, for example, incorporating community amenities such as green space. To be effective, resilience needs to be integrated; real estate is part of a wider system so look at how resilient other parts of the system are and look for ways to invest in measures that achieve multiple benefits.

Adaptability should be built into long-term planning, to incorporate potential changes to technology, working patterns, population, usage, loading and transportation modes, for example. Agility should be developed to maneuver quickly in a changing risk landscape to avoid risk and seize opportunities; spotting the next trends, for example, where the next up and coming area is. And finally, resilience is reflective; an ongoing process of continuous assessment, learning and improvement, so monitor performance of assets, capture lessons learned and learn to thrive not just survive. □

How to create resilient assets

1. Understand the greatest risks and opportunities within your portfolio. Consider the shocks (floods, terrorism), stresses (changing demographics, urbanization) and trends (how these change over time) that will affect your portfolio. Use this to guide future investment decisions (locations and sectors).
2. Conduct a resilience assessment (gap analysis) on your portfolio to prioritize assets where resilience capacity needs to be increased.
3. Develop a strategy for your portfolio that plans for resilience with a combination of integrated measures that balance upfront mitigation with the risk of potential downtime and recovery cost.
4. Determine resilience requirements for future projects with tenants based on risk, cost and benefits.
5. Take a broad view by considering the resilience of locations and communities, and how your assets contribute to this.
Forging ahead with the evolving pace of ESG

The impact of sustainability on private real estate ramps up with every passing year. Eric Duchon of LaSalle Investment Management explains how the firm is responding.

When PERE spoke with LaSalle Investment Management for last year’s sustainable investing report, the firm had just published its white paper Environmental Factors and Real Estate Demand, which set out how the firm would grow its focus in the area. A year on, Eric Duchon, global head of sustainability, tells us how the firm’s approach continues to expand in line with investor expectations.

PERE: Where has your focus been in the last 12 month to ensure LaSalle continues to expand its sustainability practices?

Eric Duchon: Sustainability standards in global real estate continue to evolve at a rapid pace due to both market and regulatory forces recognizing real estate’s impact on climate change. We remain focused on being a leader in the evolving area of ESG issues through continued integration of best practices across our public securities and private equity business. The aim is to help investors think about efficient ways to better analyze, price and integrate environmental factors into the risk-return evaluation of each asset.

Within our global framework, each region has its own approach to environmental management. Accordingly, whenever an asset is acquired, we work to understand the sustainability qualifications, identify areas for improvement and ensure that environmental performance has the potential to lead to enhanced investment performance. That means constantly educating employees about environmental factors and having established task forces to accomplish this, so they feel empowered to use their role to truly realize the opportunities of a sustainably managed portfolio.

Asset management is our biggest focus, as within our existing portfolio there is tremendous opportunity to reduce our environmental impact and carbon footprint. Asset managers are key stakeholders. Therefore, we train them to think about ESG at every decision point from development of guidelines for green leasing to implementation of energy, water and waste reduction projects. It is critical to be very cognizant of how these programs impact the bottom line and to be sure that we are passing on those savings to investors.

From an industry perspective, LaSalle remains an active signatory of the Principles for Responsible Investment (PRI) and have recently signed on to the United Nations Environment Programme – Finance Initiative’s (UNEP FI) Task Force on Climate-related Financial Disclosures (TCFD) Real Estate Investor Pilot. In this initiative, we are working with peers and competitors to identify and minimize our impact on climate change.

PERE: Are investor expectations and demands growing and expanding?

ED: Investor expectations are definitely growing and expanding. As a fiduciary to our investors, long-term value creation and protection is fundamental to our business and we believe that ESG best practices can enhance returns. We are seeing more push from investors all over the world, especially in Europe and coastal US. They are asking new and deeper questions demonstrating their increasing knowledge of this
subject and their growing involvement in industry ESG initiatives. Investors are asking us to expand our horizons in this area and take a greater leadership role, so we continue to define our impact on climate change, identify opportunities for building-level resilience initiatives and explore the newest trending area of social impact investing.

To continually demonstrate upward movement, we also report annually to industry assessments, and LaSalle now has a three-year track record of an A+ in our PRI Strategy and Governance assessment and enjoyed our strongest year of GRESB performance since we began submitting in 2012.

**PERE: How important are new technology and data management strategies as part of the sustainable investing equation?**

**ED:** They are definitely important, but it is even more critical to ensure that we use the right technologies and strategies for our buildings. No single technology is going to fit a diversified portfolio like ours. When I’m being sold on these new technologies and hear “you can reduce energy or water consumption across all of your buildings,” I immediately pause because there is no silver bullet.

We have a system in place to ensure that we evaluate each new solution via a pilot program that deploys the new product at one or a few assets where we believe it could work at a very low cost so there is no financial impact to us. If the pilot is successful, we roll out to the applicable assets in our portfolio. Many of these pilot programs will have a direct benefit to our tenants as they impact energy operations, so we work closely with their teams to ensure the programs are mutually beneficial.

**PERE: Is tenant engagement important?**

**ED:** Extremely. In the US, we saw this recently through feedback in our annual tenant survey. Similar to investors, tenants are placing more importance on sustainability than ever. We have to engage tenants according to property type, among others, to be successful. For example, in our asset management program with the tenants.

At office and multi-family properties, this has been standard for some time but at retail and industrial assets, LaSalle is pushing the envelope to work together on ESG initiatives, for instance financing lighting retrofits in tenant-controlled industrial buildings. We are actively working to increase awareness of sustainability factors as an important consideration for tenants across all property sectors.

**PERE: Talk us through an example of where sustainability improvements have led to better investment performance**

**ED:** In 2015, we acquired 222 Exhibition Street, a multi-tenant office building built in 1989 in Melbourne. Our asset management team identified the opportunity to improve both the sustainability performance and investment performance through a long-term, asset lifecycle approach, with the stance that exceptional outcomes could be realized without millions of dollars of capital expenditure. Our goal was to achieve a high NABERS rating in order to attract the right tenants.

While common for a new office building to target high NABERS performance, existing commercial properties face challenges from legacy systems and complexities of making changes without inconveniencing existing occupants. We started with an extensive analysis of the building’s systems and performance. Once completed, we established an improvement plan that optimized existing services and upgraded the end-of-life plant with new technology, with a particular eye on reducing energy consumption. Highlights include optimizing mechanical systems controls and cooling towers, improving air-conditioning and ventilation strategies, implementing a proactive maintenance approach, upgrading wellness amenities and instituting a best-in-class waste management program with the tenants. In essence, we took an outdated building from the 80s and made it a sustainability success story that is attracting new tenants and investors alike.

**PERE: In your view, how does an investment manager go above and beyond to improve ESG performance?**

**ED:** ESG practices cannot be conducted in a vacuum; we believe that fully integrating our ESG mandate into all investment functions is critical. However, these initiatives must be tailored according to factors such as geography and property type, among others, to be successful. For example, we undertook a global initiative for each region to establish ESG processes during our due diligence of new acquisitions. These regionally customized processes establish a baseline for each asset team to improve ESG performance.

While the core responsibility for ESG initiatives remains with our sustainability officers, our energy and sustainability task forces are the true reason we can go above and beyond. Professionals across business functions are critical to providing the insights and perspective that enable us to take action and implement ESG initiatives at every point in our investment process, from acquisition to asset management, to ensure we successfully reduce our environmental impact.
Creating a sustainable heritage

How do you construct real estate sustainably in the middle of an ancient city? Helen Lewer travelled to Edinburgh, Scotland’s scenic capital, to find out

Walking out onto Princes Street from Edinburgh’s Waverley station, past the iconic Balmoral Hotel, the city appears to have changed little in the decade since this writer last visited, save for trams whizzing around, a charming feature opened in 2014. Looking skyward, however, the sight of some impressively tall cranes offers the first indication of a major development underway.

This is Edinburgh St James (ESJ), billed by its developer and minority owner TH Real Estate as currently the largest privately backed regeneration project in the UK. Given its scale it would be foolhardy to challenge that assertion.

When it opens in 2020, Edinburgh’s near 600,000 residents and four million odd tourists that visit annually to enjoy its ancient history and festivals – there are six in August alone – will have access to a modern shopping mall, luxury five-star W Hotel, new homes and Everyman cinema. Hurrah! Because anyone familiar with Edinburgh knows you do not go there for the shopping – literature, history, culture, the arts, yes, but not for a weekend of retail therapy.

The ESJ project has also become a standard bearer for sustainability initiatives in the private real estate sector, and not just in the environmental sense.

Sustainability through a wide lens

Real estate investors and managers are growing acutely aware that when they put their capital to work in a project, long-term value creation and investment performance of an asset is tied closely to the wider community in which it operates. Private money is playing a meaningful, indeed central role, in supporting and driving the resiliency and long-term socioeconomic wellbeing of localities. Assets survive when a neighborhood thrives is becoming a common mantra. That
means ensuring the community supports the project, sees it as a value-add and uses the facilities on offer. And it often means creating jobs to sustain it.

“Back in 2006, when we bought the land, when people talked about sustainability it was all about carbon reduction, thinking about the use of energy and how you use it efficiently”, says Martin Perry, Edinburgh St James project director for TH Real Estate, “but we always viewed it as much more than that. Projects must also be financially sustainable too, and a critical component of that means improving the livelihood of the people in the communities we work in.”

Dutch investor APG, the majority owners of Edinburgh St James and strong promoter of ESG and responsible investing in the private real estate investment community, is also an advocate of sustainability goals that go beyond the environmental. “We were keen to use this project to forge a relationship with the community, because it is a large project and it has a big impact on the local community, we hope in a positive way going forward. Ultimately, the project will create in excess of 3,000 jobs and that’s helpful to us as an investor as well,” says Robert-Jan Foortse, head of European property investment for the firm.

Edinburgh St James is demonstrating best practice of sustainability in this much wider sense in several ways, both during the construction phase, of which it is in the midst, and beyond when the asset becomes operational.

**Economic impact**

A strong commitment to employ locally is built into the ethos of the project, explains Perry. Around 67 percent of the construction site workforce lives within a 50-mile radius of the city and a number of local businesses have been contracted to the project, too.

A construction academy is in operation, collaborating with local schools and colleges to help inspire the next generation of workers in the sector and to develop the modern skills required. Both school-age pupils and university students are enjoying exposure to the practicalities of a career in the industry in areas as diverse as planning, design and engineering. Graduates are currently onsite doing work placements. And there is a series of apprenticeships and volunteering initiatives in place. Employment was even found for some workers made redundant by another local company.

Then there is FUSE. Formally launched in March this year and part of a Growth Accelerator Model (GAM) agreed between Edinburgh St James, the Scottish government and City of Edinburgh Council, this program creates a retail and hospitality academy. When Edinburgh St James opens in 2020, it will generate 3,000 jobs. FUSE’s remit is to guarantee there are job-ready, highly trained staff ready to fill those vacancies on day one. And it is delivering this by creating pathways for school leavers, career changers and people looking to re-enter employment after a career gap, to find meaningful and fulfilling long-term careers in the sector.

Rochelle Burgess, associate director of Savills Project Management, says: “It’s the aspirations of the project and our investors to create sustainable employment in the long term, not only for Edinburgh St James, but for the wider retail and hospitality sector in Edinburgh, raising the profile of the sector as a worthwhile career choice.”

**Winning hearts and minds**

A unique feature of this particular project is the locality in which it is being built. Edinburgh is a UNESCO World Heritage site and community engagement has been taken seriously as a result throughout the project from design through to construction. A project of this scale, in such...
an ancient and historical site, can only be sustainable and ultimately successful for the owners if it has community backing.

There were strict planning restrictions to consider. The City of Edinburgh Council has a skyline policy protecting the famous views of the cityscape from the castle and Calton Hill. To get the project approved, and to get buy-in from a discerning population proud of their city, this had to be factored into the design. “The crescent shape of the design picks up on the geometric shape of Edinburgh’s New Town, so it very much has the structure of this part of the city in mind,” says Perry.

Edinburgh had got this badly wrong in the past. The original St James center, opened in 1975, was described as a carbuncle and a monstrosity, failing spectacularly to enhance the elegant listed Georgian-style properties surrounding it. When TH Real Estate originally bought the existing center in 2006, it was aware that any redevelopment had to complement Edinburgh. “If you look at shopping center development in the last 30 years, it’s often damaged the look of cities; from the outside you often just see just the back of shops. You can’t do that in Edinburgh. We deliberately set out to create something that fits with the city,” explains Perry.

Environmentally sound
The environmental component of the sustainability conversation remains important, especially in a UNESCO site, and the construction phase of a major real estate project throws up plenty of challenges. Again both TH Real Estate and the contractor Laing O’Rourke carefully considered this at the outset, and prioritizing sustainability and respect for the city’s heritage at the center of its agenda helped garner built-in support for the development of Edinburgh St James.

Perry explains: “The Scottish government is probably more sustainability focused than even the UK government, so they were always very supportive of us. And there are a lot of interest groups in Edinburgh looking at issues such as air quality and waste management; a lot of areas that as a business we focus on. We could show how we were going to deliver on these issues and construct in a very sustainable way.

“On a construction site, there’s lot of potential for pollution caused by noise, dust and vibration. We have a lot of monitoring points around the site to keep track of these problems on a regular basis. We’re very conscious that there are people living and working next to the site, so we work very closely with the community to minimize any disruption and impact on them.”

Irene Gibb, community liaison adviser for Laing O’Rourke, adds: “Communication is key with all stakeholders and businesses. We go out of our way not to make ourselves invisible, because that is what really upsets people. We are
contactable 24-hours a day and we have to be prepared for any questions that are directed at us. It could be a noise complaint or something wrong with a road sign. We develop a rapport with people.”

Minimizing environmental and social impact is being achieved in different ways. First, by reducing the number of workers actually operating on site. “We are using as much offsite prefab as possible to reduce on-site construction. Virtually everything we are doing is assembled offsite. It is then put together like a jigsaw puzzle once it reaches the site. But this means we push the labor back to outlying factories in other localities,” says Perry.

Another positive effect of work being done away from site is better traffic management around the area, reducing residual pollution and congestion common around busy building sites. “We’ve been able to reduce traffic on the road by 30 percent,” claims Perry. “And that’s less traffic during construction of the new site than when the original center was in full operation.”

Another core sustainable target of the project has been to recycle demolition and waste material from the site. “All material is reused entirely. Close to 99 percent of everything that’s come out of the site has been reused. For example, the materials get crushed and then reused for reclamation at the port. Some of it has also been reused for other purposes such as road construction elsewhere in the city.” They’ve even gone as far as to reuse traditional cobbledstones removed from another part of the city to refurbish a cobbled street, very much in keeping with the area around the site.

Looking ahead
Sustainability will not come to an end in 2020 when Edinburgh St James opens. It will be a core feature when the complex is fully operational. And one plan is for Edinburgh St James to do its bit to improve the city’s capacity for electric cars. There are just 17 electric car charge points in Edinburgh. ESJ wants to create 150 more and make that accessible to people throughout the night when the center is closed and parking not at capacity; looking at how to maximize the utility of a space at all times. Retail, hotel, leisure and residential parts of the scheme are also being asked to share facilities – residents being allowed to use the hotel leisure facilities, for example – promoting the efficient use of space, savings costs and cutting energy and utility use across the site.

Compromises always have to be made, of course. On this project, the use of photovoltaic, a standard sustainable feature of new developments nowadays, has been forgone. Here, locality has been an Achilles heel. Simply, you cannot have unsightly solar panels on a building overlooked by millions from Edinburgh Castle. The view over the city is non-negotiable.
Real estate with a social conscience

Impact investing is a talking point in the sector now and it doesn’t mean having to sacrifice the bottom line, says PGIM Real Estate’s Lisa Davis

Impact investing is the nexus between achieving competitive investment returns, and positive social and environmental outcomes; goals that in the past were often seen to be in opposition. Lisa Davis, PGIM Real Estate’s recently appointed executive director of impact investing, explains how that perception is changing as investors increasingly understand that achieving a positive impact can also drive returns.

PERE: We hear a lot more about impact investing these days? What is driving progress in this area?
Lisa Davis: Investor demand is a key factor. As a more diverse group of individuals, including women and the next generation, gain increasing input into investment decisions, they bring a greater desire to achieve a positive impact with their investments, not just their philanthropy. Investing reflects their values in many ways – shareholder activism, consumer choices and impact investing. This drives additional flows of capital, innovation and more accountability across the financial sector.

PERE: What real estate markets and assets present attractive opportunities for impact investing right now and why?
LD: Real estate has a profound impact on people’s lives and the environment. At this point in the cycle, we are paying close attention to investment strategies that are defensive and less correlated, and to opportunities that create value by investing outside core markets and the highest value locations. Multifamily affordable housing can be defensive and undervalued. It’s generally more resilient to economic shocks than other real estate sectors and its shortage means it has extremely low vacancy rates and sticky tenancy. Almost half of all renters in the US pay more than 50 percent of their income toward housing costs and rents are rising faster than incomes in most markets.

At the same time, institutional capital has a much lower penetration in the sector, particularly in the ‘naturally affordable’ Class B and C apartments. This indicates there may be some mispricing and an opportunity to improve net operating income through scale, capital investments and high-quality property management. Many investors feel margins are thin and costs are high, particularly in core locations in gateway markets.

Investing in non-core areas that have been out of favor with investors in the recent past is one way to create value. Select non-gateway markets are good value, particularly secondary markets experiencing growth and that are more affordable than coastal markets. This is where we can create a high impact by focusing on community needs, bringing essential community services and amenities, and enhancing the community experience in locations that have been lacking new investment.

These developments seek to transform both the property and the community, and to catalyze additional investment. We work with operators and partners aligned with this mission, that have deep local connections and a demonstrable track record in sourcing public finance to create value and find opportunities that may be otherwise missed.

PERE: How do you create investment performance through impact investing?
LD: It starts from the same fundamentals that lead to profitability in other real estate investments: experience and judgment in selecting investment opportunities; management of execution, market and operational risk; a solid research foundation and insights into market fundamentals. Impact investing can also drive alpha through investing in property types and locations that are undervalued, using impact programing to enhance performance through improved tenant satisfaction and catalyzing additional investment in a neighborhood by thoughtfully addressing community needs.

Perhaps the most important aspect that sets apart strong impact investment managers in the real estate sector is effectiveness of execution. Research shows that diverse teams are more effective. When impact managers, properties and contractors have diverse organizations they can access and retain the best talent, reflect the communities they serve and be better positioned to capture the innovation that comes from diversity of thought. This leads to the best execution of impact strategies.

PERE: How do you measure and report performance from impact investing?
LD: Impact measurement is rapidly evolving and the range of measurement systems can be confusing, but it’s becoming
increasingly standardized. Environmental impact standards at the asset level vary by region and property type, but there are sufficiently consistent frameworks that owners and investors can use as benchmarks, such as LEED and BREEM.

At the fund level, GRESB is an excellent tool for gathering and reporting performance. However, there is more variability in measuring social priorities. The Global Impact Investing Network’s IRIS metrics provide a comprehensive classification for measuring social outcomes at the asset level. UNPRI also asks helpful questions for setting and reporting fund-level policies and practices to achieve social outcomes. Although translating the UN Sustainable Development Goals into specific real estate practices is challenging, the industry is starting to adopt ways to connect investment decisions and management to SDG outcomes through frameworks such as the UN Environment Program’s Positive Impact Property Working Group.

Our impact measurement and management framework analyzes the social aspects of a property’s location to help inform the business plan for the asset. For example, we consider neighborhood school quality in the context of a regional average which, combined with data about the number of school-aged children in a property, can guide community managers in programming for children and youth, connections to transportation to alternative schools and resident turnover for families with children who are dissatisfied with nearby schools.

**PERE: Is impact investing risky and, if so, how do you mitigate that?**

**LD:** It can be inherently less risky. For example, affordable housing has a lower default rate and has experienced less cap rate compression than other sectors, making it more resilient across market cycles. Transformative development also seeks to use public financing to serve in a top-loss capacity and to create momentum in development scenarios to protect it from credit tightening. Fundamentally, when you are providing for basic human needs such as stable housing and essential services, these investments may be less cyclical in the level of demand.

Many elements that create positive social and environmental impact also mitigate investment risk. For example, investing near new transit locations creates stronger returns than car-dependent locations. In the last downturn, walkable locations lost much less value than other locations.

**PERE: What is the role of public policy and regulation in impact investing?**

**LD:** Markets that provide impact investment opportunities generally require government and philanthropic support to build infrastructure and scale. Regulations, tax incentives, credit liquidity and subsidies help align investments with desired public goods. As markets mature, the nature of support may move from subsidy and regulatory requirements to incentives and consistent regulatory guidance.

State and local governments, along with the private sector, have come to see the affordable housing crisis as a threat to economic expansion and quality of life, and have stepped up to address it. This is evidenced by inclusionary zoning programs, which require private developers to dedicate a percentage of units for tenants below a certain income. Another example is the recently passed ‘Opportunity Zone’ program, which provides tax incentives for investing in areas requiring revitalization.

**PERE: What is the ultimate goal in impact investing?**

**LD:** The goal is that investors can invest for positive social and environmental impact across their portfolio, and that impact considerations factor into all their investment decisions. As the number of impact strategies grow and investors become more aware of their impact requirements, the real estate industry will increasingly understand its full impact on people and the environment and embrace the significant opportunities for positive change.

**Making a difference**

Three best practice tips to track and measure impact investment performance

1. Set measurable or observable impact targets and consistently track and report against them.
2. Recognize that all impacts should be observable, but they may not always be measurable. The quality of community and social connections at a residential property may be hard to quantify, but are essential to quality of life, feelings of safety and tenant retention.
3. The real opportunity for enhancing returns – financial, social and environmental – lies in the analysis of key data to manage performance through constant learning and improvement.

“As a more diverse group of individuals, including women and the next generation, gain increasing input in investment decisions, they bring a greater desire to achieve a positive impact with their investments, not just their philanthropy”

Lisa Davis
The head of sustainability for Shorenstein Partners takes his mandate seriously, even in his commute. Jaxon Love cycles to the firm's San Francisco headquarters, where his day could involve talking city legislation with government officials, boilers with engineers or health and wellness trends with investors.

Love, who joined the vertically integrated firm in 2012 as its first sustainability program manager, says he wears many hats in his role. Underlying his various tasks, from technical operations to investor communications, is a passion for sustainability he says his peers across the industry share.

As investment managers eye more onerous sustainability reporting requirements and increasing investor interest in sustainability, particularly as American investors catch up to their peers, general partners must consider how best to staff their efforts. One New York-based recruitment executive says the positions are generally created from within organizations or added onto an existing employee’s duties.

Even the largest firms are divided on hiring a dedicated sustainability executive or not. Of the top 10 names on PERE’s annual list of the largest private real estate investment managers, six staff such functions, though some of the roles have cross-asset class mandates. One, Boston-based AEW, has a sustainability committee co-led by its vice-president of architecture and engineering and its director of asset management.

Shorenstein’s approach to the human capital side of sustainability demonstrates how firms are changing. The firm, which oversees $7.9 billion, operated with a sustainability committee, rather than a dedicated employee, for five years, before Love joined. Back then, sustainability efforts at the 290-person firm already included LEED certification, ENERGY STAR benchmarking and tenant engagement activities.

**Staffing for sustainability**

As ESG becomes more important to investors and reporting more onerous, firms evaluating how to man their efforts find myriad options. By Meghan Morris

"As investor inquiries have matured, we have matured as well"

Jaxon Love

Shorenstein: integrating ESG under a head of sustainability
“These things were starting to take off at the time and were becoming a fairly significant part of multiple people’s jobs,” Love says. “The decision was made as an organization that there seems to be a trend here that’s going to continue, and we should resource this appropriately.”

Initially, Love was tasked with tracking and measuring the firm’s existing sustainability footprint, then to implement a process to manage and quantify it over time. As more US cities added reporting requirements over the years, Shorenstein could pull existing data, rather than hiring a consultant to manage the process, Love says. Now, his mandate is to think strategically about adding value and emerging trends, such as health and wellness.

He continues to work with the sustainability committee, which meets monthly and includes representatives from the firm’s various departments: transactions, asset and property management, human resources, IT and accounting. Other firms take a similar approach: AEW’s committee is set up with functions including asset management, research, risk management and legal and compliance, among other verticals, reporting up to the co-heads.

“Think of that committee as the nervous system for sustainability throughout the organization,” Love says. “It allows information to flow in both directions so that I can learn what’s going on throughout the organization and hear good ideas that come up, because a lot of folks are interested in this topic personally and have a passion for it.”

In one recent example, he says the capital transactions team asked for materials to help new analysts understand how sustainability works and how they play a role.

Tracking success

Some elements of a sustainability manager’s job are more easily quantified than others. Before Love joined, Shorenstein set a goal of reducing energy usage by 20 percent from 2008 to 2020 – a goal the firm achieved last year, which saves $6.5 million annually. Meanwhile, last year, the firm completed 58 efficiency projects, saving $650,000 annually. Love highlights that while he played a role in those reductions, credit goes to the entire organization, particularly property managers and engineers. He also works on tenant engagement, which is more difficult to quantify but is “an intangible component of attracting and retaining high-quality tenants.”

As he continues these existing mandates, Love’s job is further expanding in scope to include more of the social portion of ESG.

“As investor inquiries have matured, we have matured as well. We for a long time as an organization had a very strong sense of purpose in the community about giving back, but we didn’t talk about it in the context of sustainability – sustainability was the green stuff,” he says. Now, the annual sustainability report includes information about that concept.

Alternatives to an ESG head

Smaller firms that lack Shorenstein’s size and scope often tack sustainability onto an employee’s job description. Irvine, California-based private equity real estate firm Avanath Capital Management, for example, originally tasked chief operating officer Jun Sakumoto with overseeing ESG initiatives for the firm, which manages 67 properties. As his role expanded, the multifamily-focused firm tapped its vice president for fund management, Ada Arevalo, for the mandate. She focuses largely on sustainability reporting and interfacing with investors, including organizing the firm’s first impact investing conference this summer. Meanwhile, Avanath’s asset management group manages on-the-ground projects.

About six years ago, the firm took a closer look at its sustainability practices when it acquired properties in Sacramento, California. At the time, Sakumoto said the firm did not underwrite any increases in water expenses following a drought. When water costs spiked, Avanath decided to install various improvements to lower utility usage. While Arevalo focuses on reporting, the property-specific ESG implementation is done by asset management and property management groups, which have a better sense of what individual assets need.

“It may not make sense to install solar panels on a property in Chicago, but it may make sense in California,” Sakumoto explains. “Compared to other private equity managers, we’re a relatively small firm. Once our portfolio gets larger, we’ll consider adding a full-time sustainability person. Right now, having the current team in place is working for us.”

Love: oversees Shorenstein’s sustainability efforts

Sakumoto: delegated ESG as role expanded
Implementing ESG best practice must be tailored to each country, property sector, market and sub-market, tenant profile, investment period and local regulatory environment, among other factors. For that reason, LaSalle has energy and sustainability task forces in each region and for its public securities business to lead its ESG efforts.

In North America, a bifurcation in regulatory policy on environmental issues exists between the progressive federal policy in Canada and the lack of current federal support in the US. While there remains an ongoing political debate in the US regarding the occurrence of climate change, both countries have state and local policy initiatives. In conjunction with local regulations, market forces from both investors and occupiers drive implementation of ESG in real estate. While local policy issues, for example annual energy benchmarking disclosure, make it easier to collect the data to form baselines at the asset level, LaSalle drives forward energy efficiency and sustainability initiatives as best practice across all markets and property sectors.

From the acquisition and due diligence process to asset management activities, it is important to identify ways to optimize ESG efforts across the investment strategy. Recently, we implemented an ESG checklist during acquisition, which summarizes an acquisition’s energy and sustainability credentials (such as Walk Score and certification status), current operational issues (energy spend and recovery), market factors and incentives (occupier perspective and utility rebates), and local regulations. This checklist is then translated into an overview of sustainability in an investment committee memo and forms the starting point for setting an asset-level ESG baseline.

Once an asset is transitioned into the portfolio, the asset management and sustainability teams work hand-in-hand to influence daily operations, capital upgrades and work with tenants. As a component of the annual budgeting process, a Property Sustainability Plan is completed to reflect each asset’s current sustainability performance and identify opportunities for improvement, such as certifications.
and building systems audits and retrofits. These plans are then input into the Environmental Management System (EMS). Together with the ongoing energy, water and waste benchmarking conducted in the EMS, the progress of each asset against its sustainability plan is continually updated to ensure continuous improvement.

**Europe**

Environmental legislation has been a driver to sustainability for a number of years, with both country-level regulations and EU directives. Energy Performance Certificates (EPCs) are the most visible; each country has implemented this directive in its own way, which has led to confusion since there is no consistency in the methodology for assessing an EPC. The Netherlands and the UK have led the way by setting minimum EPC ratings for lettings. This has been effective in pushing landlords to make energy efficiency improvements. However, other countries lag behind and are yet to fully implement the requirement for an EPC. Compliance aside, interest in ESG from institutional investors across Europe continues to gain momentum, whether large Dutch pension funds, UK local authority pension funds or French government pension funds.

To formalize our own approach in the region, we launched a European Sustainability Strategy in early 2017. This sets out a four-year road map to ensure ESG risks and opportunities are considered at every decision point. For example, EPC ratings, building certification and flood risk, and other material issues are reviewed at various points throughout the acquisition process. The Investment Committee then tests each new acquisition against a set of Sustainable Investment Principles to ensure assets are bought with either good sustainability profiles or with improvement potential.

During the hold period, there is an opportunity to maximize operational performance. This has the double benefit of reducing an asset’s environmental impact and delivering savings to tenants. The European Sustainable Management Programme operates across our operationally controlled assets, allowing us to collect environmental data, set reduction targets, engage with onsite teams to identify improvement projects, and track and report progress against targets. For our standing assets, sustainability is built into the annual asset business plan.

During the planning process, risks such as low EPC ratings can be mitigated and capex implications accounted for in investment appraisals. At this point, a review is undertaken of opportunities to upgrade an asset either by seeking to obtain certifications like BREEAM, HQE or DNGB, or to install renewable technologies such as rooftop solar arrays, both generating income for investors and delivering cheaper and cleaner energy to tenants.

Development and refurbishment projects are a key opportunity to upgrade the portfolio and are all carried out in line with our Sustainable Development and Refurbishment Standards, which set out best practice aspirations and minimum standards across 12 areas of environmental aspects such as energy, waste, water and flood risk, as well human issues such as health, wellbeing and community engagement.

The firm is also chairing a new green lease working group for the UK Better Building Partnership, which aims to share best practices on green lease clauses and ensure tenant adoption.

**Asia-Pacific**

ESG efforts in Asia are driven primarily by market force requirements for sustainability by end users that are, in part, reinforced and encouraged by increased regulatory requirements. With operations across multiple countries with differing market and regulatory forces, ESG efforts must be customized to each asset. The Australian market tends to

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**“Interest in ESG from institutional investors across Europe continues to gain momentum, whether large Dutch pension funds, UK local authority pension funds or French government pension funds”**

Sophie Carruth

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**“In China, especially in the major cities, end user requirements for sustainable residential projects and a demand to improve indoor air quality in offices is raising the general visibility of sustainability”**

Tom Miller
be the most robust in terms of the penetration of sustainability into the real estate market. The synergistic relationship between market-driven forces and continued fine-tuning of government regulations provides a positive feedback loop, which results in year-on-year improvements to the overall sustainability of the real estate market. Singapore is not far behind Australia, albeit it is a more a regulatory driven process.

Japan’s market forces continue to increase, supported by an improved regulatory environment. We expect to see strong positive movements for sustainability in this market. In China, especially in the major cities, end-user requirements for sustainable residential projects and a demand to improve indoor air quality in offices is raising the general visibility of sustainability.

These differing market and regulatory forces across the region mean the focus is to ensure we prioritize continual improvement of sustainability factors into strategic plans, both at the acquisition phase and the operational asset management phase. At acquisition, a sustainability section is included in investment committee memos to indicate the current state of sustainability of the potential investment, as well as an outline plan for future improvements. In operational asset management, sustainable improvements are driven through a number of initiatives. First, we create bespoke, annual energy and sustainability management plans for each asset, since the financial viability of sustainability improvements for an asset depends on the specific local market and the intended hold period. Initiatives are implemented that either improve the financial performance (or are financially neutral) and/or those that protect from potential downside impacts. In leasing, a full range of potential green clauses have been created, which can be tailored to each market to push sustainability on a market sensitive basis. Initial successes at Australian assets as well as a start in Singapore point to this being an area of focus.

Active participation in regional sustainability forums such as the ANREV Sustainability Committee and the GRESB Asian Benchmark Committee is critical to ensuring we remain at the cutting edge of real estate industry sustainability issues in the region.

**Real estate securities**

ESG factors can have an impact on investment performance and should be integrated into the analysis when evaluating real estate securities. An investment valuation process provides a framework to incorporate and consider ESG issues. A best practice approach includes:

- A commitment to clients to strive to deliver superior investment performance.
- A commitment to adhere to the UN Principles for Responsible Investment.
- Identifying ESG issues that represent risks and opportunities, which can have a positive or negative impact on investee companies. Each company’s approach to managing ESG issues has the potential to impact its value in the market and thus the value of clients’ investments.
- Determining an Intrinsic Value for each stock, taking into account a multitude of factors, not any one of which can be relied on exclusively to drive the performance of a stock. ESG factors could be impactful in:
  i. the analysis of a company’s projected earnings (rental rates achieved, return on cost on new developments);
  ii. determining the risk/required return for a company’s real estate, business model, and management capabilities;
  iii. and determining the long-term growth potential of a company’s earnings.

Encouraging investee companies to manage ESG issues appropriately is in the best interest of clients and society as a whole. Our Engagement Guidelines provide a framework to seek and encourage ESG disclosure related to the approach, practices and performance of the real estate companies in our investment universe. Through our engagement, we encourage these companies to identify ESG risks and opportunities material to their business; manage their ESG risks effectively; enhance their corporate disclosure of ESG policies and performance and seek industry best practices on ESG issues.
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Why the ‘S’ in ESG matters
Tsilah Burman of CBRE Global Investors explains to PRI’s Simon Whistler why a community emphasis and tenant engagement has a real impact on the bottom line

Each year, the UN-supported Principles for Responsible Investment conducts its member-reporting process to gauge how investors and investment managers are responding to ESG requirements. And there’s a positive improvement in the direct property investing module. In 2017, 28 percent of the 205 respondents scored an E-grade, the lowest available, and 26 percent an A-grade. In 2018, on the other hand, of 189 respondents only 3 percent scored an E grade while 40 percent achieved an A grade. With these results in mind, PRI’s senior manager, real assets, Simon Whistler spoke to Tsilah Burman, senior director of CBRE Global Investors, to get an inside view on how seriously the investment community is taking sustainability, and finds out there’s a growing emphasis on the social component of ESG.

Investor understanding improving
Simon Whistler: It’s difficult to make like-for-like comparisons given the number of respondents in the PRI property module changes from year to year, but we’ve seen an overall improvement in respondent scores. While it’s too early to know the full reasons behind that improvement, it does suggest a greater level of understanding of ESG processes and reporting among this years respondents. Are you seeing this in the North American market?

Tsilah Burman: I think that’s the case both in North America and in the global market. Within the last two years we’ve had more collaboration within our own firm in completing the PRI module, which has led to greater consistency in data collection and reporting. We have continued to expand our ESG initiatives to be a leader in ESG integration. In the last two years, we’ve also created a new ESG structure within CBRE Global Investors, so we now have a global responsible investment management committee and regional and business line committees on which experts who know about ESG matters sit. The members of these committees serve as advisors to our investment teams to ensure we integrate ESG into everything we do.

SW: Over 90 percent of respondents to the PRI module report they take ESG into account when selecting investments. Probably, there is no surprise there. Energy efficiency is the most frequently cited consideration (84 percent). Frankly, the cost savings that energy efficiency achieves is driving awareness and performance. But it’s interesting to look at some of the other factors that come up most frequently, including health, safety and well-being, and building safety and materials. It’s these issues that reveal a variation in focus between regions. Building safety and materials, for example, is a dominant issue in America whereas occupier satisfaction is a much greater consideration in Europe than elsewhere. Can you explain some of these peculiarities and what CBRE takes into account?

The tenant factor
TB: We have several proprietary operating programs that address the ‘S’ in ESG by creating spaces that actively engage the tenants and tenants’ employees and address health and well-being issues. And we reach out to the broader community through programming, philanthropic activities and activating outdoor space, and are having a more profound impact there.

“At PRI, we are looking at some of the innovations in the real estate market, such as green leases and green mortgages, and how that’s changing the market”
Simon Whistler
too. Focusing on tenant and community needs and creating a customized environment and experience for tenants and the greater community results in higher tenant satisfaction. Obviously, that means tenants are staying, they’re renewing leases, there are less turnover costs, and ultimately that has a positive impact on the bottom line. We have found that satisfied tenants are 2.8 times more likely to renew than those who are unsatisfied. So this element is important throughout our global portfolio, whether in the US, Asia or Europe. We do tenant engagement surveys on an annual basis because tenant satisfaction is not only an important indicator for lease renewal but also of how we’re performing as a business.

SW: It’s clear just from talking to investors like yourself that there is obviously much greater understanding and emphasis on community and how real estate can shape and support people’s lifestyles.

TB: Well let me give you a recent example. We had a property in Seattle, two buildings that were on the fringe of the downtown area. What activated the open space between the buildings and put retail tenants in on the ground floor that responded to both tenant and community needs. We ensured that the open space benefited both the tenants in the building and the wider community. As a result, the area was no longer thought of as a fringe location; it became a part of the traditional downtown of Seattle.

SW: Looking at the results of the PRI reporting module, the vast majority of respondents are monitoring ESG performance whether they’re investing directly or through investment managers. But I think it’s fair to say that monitoring and measuring impact is something that’s still evolving and there’s a lot of work still to be done here. For example, it’s relatively easy and commonplace to look at integrating energy efficiency in the design of real estate, but there’s less emphasis on how efficient a building is in reality based on how occupants and tenants are using energy. How do you see this evolving over time in terms of the reporting and requirements that you need as the investor? How do you see the market adapting?

TB: We use Measurabl, a software provider, to collect consumption data across the platform. Office properties are easy; we have control there; we can set KPIs and targets and monitor to make sure target reductions are met. But it’s more difficult to do this in the industrial, retail and multi-family sectors where we don’t always receive consumption data from our tenants due to the nature of the leases. This is where we try to create relationships with the tenants and hope to encourage them to also be concerned about ESG factors, to reduce their consumption and, for example, to use LED lighting and install low-flow toilets. But the bottom line is we don’t have control over that, so there’s only so much we can do.

From a property perspective, that’s what engagement is about. Engagement for listed equity entails engaging with companies to improve their ESG metrics, but for the direct side of our business engagement is more about working with our tenants and reaching out to other stakeholders to let them know why they should be concerned about ESG factors and the differences it can make for them.

The return game

SW: All of what we’ve discussed already needs to fit into financial returns as well and the critical thing here is that you can implement all these processes, gather the right data, but it all needs to generate a return on investment. At PRI, we want to raise awareness of and encourage debate around some of the innovations in the real estate market, such as green leases and green mortgages, and how that’s changing the market. Looking into a crystal ball, what are some of the developments in the market and how is that going to drive investment value going forward?

TB: Climate change isn’t yet being addressed as broadly in the real estate sector as it could be. We have to look at new building systems and ways to reduce our carbon footprint. Real estate accounts for 40 percent of emissions, yet we are not taking advantage of everything we could be doing to reduce consumption. Addressing this has the potential to help with returns. When tenants are happy, when their operating costs have gone down, they are more likely to stay at the property. That too is a bottom line issue. In this current return environment it’s really important to keep costs down and create value. I think that’s where ESG comes into play in not only mitigating risks, but in finding alternative ways to create value.
Time for a holistic approach to ESG

Invesco Real Estate’s Michael Kirby, Etienne Dupuy and Sze Ann Ong, tell PERE why sustainable investing is moving beyond box-filling and rankings

ESG is increasingly being integrated into real estate investment decisions. Given the enormous contribution that buildings can make to both augmenting and tackling climate change, a genuinely holistic and authentic approach is needed, one that champions the importance of wide-ranging engagement and recognizes that outcomes are as important as outputs.

The environmental direction

Buildings play a huge role in shaping our climate. According to the United Nations Environment Programme (UNEP), they represent the single largest source of greenhouse gas (GHG) emissions. They use around 60 percent of all the world’s electricity, 40 percent of energy, 40 percent of resources and 25 percent of water. The places we live and work are critical to the long-term future of our planet. Institutional investors have supported the much-needed transition from brown to green buildings and the UNEP has commented that managers of global real estate assets “are one of the most important decision-making groups on Earth.”

Outputs vs outcomes

Real estate's ever-growing environmental relevance is summarized in numerous sustainability metrics, benchmarks and certifications. Such measurement and monitoring have helped foster strategies that reflect a building’s complete lifecycle, with many investments considering environmental concerns during every phase from acquisition, construction/development, ongoing management/operations and disposal in a bid to generate benefits throughout the process. The significance of these assessment instruments and tools is unquestionable, yet it is vital to note that environmental impact is not the sole criterion for identifying a sustainable building.

From an investment perspective, we might define a property with reference to broadly overarching fiduciary objectives; it should seek to lower costs, improve financial performance, achieve competitive advantage and contribute to a better world. GRESB rates ESG performance of real estate funds and portfolios managing $3.7 trillion in assets worldwide, evaluating factors including resilience or environmental challenges, health and wellbeing of tenants and occupiers, and the levels of stakeholder engagement achieved by investment managers. This holistic approach goes to the heart of the need for authenticity in ESG investing.

For investment managers it is important to establish precisely what these instruments, tools and initiatives offer in terms of genuine insight. We believe they should foster proactive engagement on material ESG issues in which dialogue, transparency and the potential for change can be considered. For example, to purchase a property that scores well on a number of environmental measures, as opposed to one that falls somewhat short of a required or recommended standard, success or failure has been determined entirely by headline environmental data, which can happen if outputs are prized over outcomes.

ESG integration has the power to effect change over the long term and it is impossible to effect such change if properties are dismissed out of hand purely on the strength of output-metrics that might be subjective in nature. But even the most environmentally friendly buildings may have only limited impact if those who inhabit them do not share in or even comprehend the benefits.

Using sustainable materials: Invesco Real Estate’s QO Hotel, Amsterdam
Investment managers and authentic ESG integration

Investment managers have started to spearhead a practical shift toward sustainability. Transparency, accountability and pride of ownership are today on the rise and to ensure good governance they first need information. They need to know all sustainability related risks and opportunities that are genuinely relevant to the asset’s prospects and performance. Although initiatives, instruments and tools might assist them enormously, data should lead to dialogue and inform decisions rather than seal them. Relying exclusively on data can condemn investment management to the realms of questionnaires, which is all about box-ticking.

The more real estate investment decisions are shaped not just by data but by stakeholder engagement and a forward-thinking mindset, the closer we get to good governance. In tandem more investment managers will assume a level of responsibility consonant with their fiduciary duty. We often hear that data is ‘actionable’ but action demands interaction that we believe marks out ‘authentic’ investment managers whose approach to real estate is underpinned both by a desire to bring about positive change and by an obligation to protect and grow investors’ wealth.

Power of active ownership: Engaging with tenants and occupiers

To support long-term strategies, interaction between investment managers and stakeholders should influence more than the initial decision to invest in real estate assets. It should also influence the day-to-day management. Active ownership is now recognized as pivotal to unlocking long-term value through responsible investing. Investors are uniquely placed to maintain and enhance the ESG credentials of the assets in which they invest.

Case study: Hotel sustainability in action

Earlier this year, Invesco Real Estate acquired the QO Hotel in Amsterdam, part of the Intercontinental Hotels and Resorts stable, on behalf of a client mandate. The hotel is part of a new breed of properties that are being built with sustainability in mind: 80 percent of the 288-room property’s lighting is sourced from natural daylight and it includes sustainable materials for all construction and day-to-day operations, such as a green roof, energy and water efficiency, and lower waste and carbon emissions.

Studies show that when investment managers take the lead in seeking to review or improve practices, they tend to get results: for example, from insisting on green clauses in lease contracts to acting on the wealth of actionable data now available from assessment tools. It can also be achieved through engagement and interaction with the people who live and work in the properties, and the broader communities in which the properties exist. The choices that tenants and occupiers make can contribute massively to an asset’s long-term performance, which is why active ownership could extend to ESG education and buy in.

Authenticity in real estate investing is a multi-layered concept as opposed to just simply metric-driven responses. It requires a holistic, forward-looking, proactive approach; it draws on data but acknowledges the advantages of dialogue; it is geared toward transparency, accountability and pride of ownership; it aims to meet the needs of multiple stakeholders and crucially it is led by investment managers that utilize the power of active ownership.

Sustainability has also become part of the agenda for our pan-European hotel portfolio, by following a top-down and bottom-up sustainable strategy and tracking of industry benchmarks. We pursue nationally recognized sustainable building ratings, adopt physically responsible green building practices and reviews, and implement initiatives applicable to each property. It’s also a consideration within our investment process and is already a part of our due diligence process.

It is vital that ESG does not become a box-ticking exercise. It is not enough merely to be seen as green and accumulate actionable data and then decide to take meaningful action. It needs a holistic view, underpinned by the willingness to act and a capacity to effect positive change. This is where investment managers, a determination to engage and the power of active ownership can make an enormous difference.

Case study: The value of tenant engagement

An authentic approach to ESG requires engagement with tenants and occupants, since how they use a building space goes a long way towards determining its performance. Engagement can take many forms and it is essential to educate them on, for example, how a property makes use of green technology. In Warsaw, Poland, our office asset Plac Unii engages with tenants through its tenant satisfaction survey, thus actively listening to the needs of its occupiers. The result is that a successful tenant wellbeing and educational program has been put in place.
Climates are not created equal

Sustainability has become a key metric for global investors, but varying climates and certification standards make it tough to compare assets across markets.

Mark Cooper reports

Certain combinations of climate and market circumstances can make it more challenging to develop and own sustainable buildings that also benefit the bottom line. It is also a challenge and therefore a cost to design and manage buildings that can cope with extremes of heat, cold and humidity while using minimal energy.

Sustainable building design and technology, while still evolving, has reached the point where a ‘green’ building can be created for any climate. For example, net-zero energy buildings have been constructed in climates as diverse as Colorado and Arizona in the US, and in the heat and humidity of Jakarta, Indonesia.

Cost concerns

A net-zero energy building is where the total amount of energy used on an annual basis is roughly equal to the amount of renewable energy created on the site or, in some definitions, by renewable energy sources elsewhere. However, the cost of construction can be greater in markets with less temperate climates.

Gregory Kovacs, design director at architect Benoy, says: “The capital cost premium for green buildings can be significantly higher in a market like Singapore than in Germany or the UK. However these figures vary based on typology and project size. The increased construction cost of green buildings often comes with a longer time for project delivery as well, both due to the relative novelty of some of the building technologies and materials required. The effect of these factors of course gradually decreases as the local industry becomes more and more familiar with them.”

Consequently, many of the occupiers of net-zero buildings are government tenants, NGOs or also the owners. In a multi-let commercial building it is harder to align the commercial interests of landlord and tenants with the aim of maintaining net-zero performance. Asset owners are increasingly negotiating ‘green leases’ to account for this, but demand for these is limited at present.

Brad Dockser, chief executive and co-founder of Green
much as the ‘green premium’ for sustainable investments. For example, Jakarta boasts an office building that adheres to the rigorous Passivhaus standard, which requires considerable investment in insulation and passive heating/cooling measures, without the use of conventional air conditioning. However, this building is the Austrian embassy and no commercial building in Indonesia meets the same standards.

Climate variations are not the only differences between global markets and arguably not the most significant. Billy Grayson, executive director at the Urban Land Institute’s Center for Sustainability and Economic Performance, says: “Differences in climate are less significant than differences in market fundamentals. In the largest global markets, the costs of adding sustainable features are broadly similar.”

For example the cost of energy varies widely between cities, even in the same country, which significantly affects the return for energy-saving building design and management. Another factor is how developed the market is and whether local tenants are prepared to pay an adequate premium for the best buildings. In many developing markets, green buildings are aimed at multinational corporates rather than domestic businesses.

However, Dockser says private equity investors need not be concerned about whether sustainability measures pay off during their hold period. “An investor’s time horizon ought not to be a barrier to sustainability. If an owner invests in measures which are proven to reduce energy costs then the improvement to net operating income can be capitalized when the building sells or is refinanced.”

The resiliency factor

Furthermore, measures that do not necessarily have an immediate effect on NOI can be valuable. An increasingly important factor for real estate investors is resilience; that is, how an investment copes with changing market circumstances, which could include legislation, tenant trends or climate change itself. Dockser argues investors should consider the ‘brown discount’ for unsustainable buildings as much as the ‘green premium’ for sustainable investments.

In a number of US cities, for example, new buildings and major renovation projects are required to achieve green certification. In the future, energy-efficiency requirements for existing buildings are likely to increase. Grayson says investors need to consider “future mid-term obsolescence,” particularly in markets where local and national government is keen to promote sustainability.

Resilience is an important factor for investment manager TH Real Estate. Sustainability manager Richard Hamilton-Grey says: “TH Real Estate has launched a number of products under its ‘Resilient’ series, which specifically factor in climate change vulnerability as part of the filtering process used to identify a focus list of cities to invest in.”

“The climate change vulnerability assessment considers three key aspects: the exposure of a location to climate change; the sensitivity of an area to climate change; and an analysis of the adaptive capacity of that area to be resilient to the impacts of climate change – for example, the capacity of national institutions, and the legislative environment.”

This strategy suggests that not only could unsustainable assets suffer, but also certain markets, such as coastal cities potentially subject to flooding. In these markets, local and national government responses to a market’s environmental challenges could be as important as the challenges themselves.

A certification conundrum

As market conditions and climates vary around the world, so do green certification bodies. This creates a headache for global investors that wish to benchmark the sustainability of their portfolio. Sustainability is a key metric for Dutch pensions group APG, where all prospective real estate investments must meet required criteria for cost, projected returns, sustainability and risk. As a global manager of real estate, APG wants to assess the sustainability of its entire portfolio, but variances in certification make this impossible at present.

Derk Welling, senior responsible investment and governance specialist at APG Asset Management, says: “The past decade has seen huge growth in certification schemes. GRESB [the Global Real Estate Sustainability Benchmark] recognizes 200 schemes worldwide, but there are around 600 in total. This makes it hard for investors to assess sustainability across a global portfolio; for example, how does a LEED Platinum rating compare to a BREEAM Excellent rating?”

Different certification regimes around the world tend to rate buildings in the context of the local climate. However, Welling believes that some multi-jurisdictional certification schemes do not take sufficient account of varying climate. He
APG would like to see GRESB take a lead role in ensuring that certification standards are comparable internationally while still taking local differences, which might include factors such as energy costs as well as climate, into account.

For APG, the sustainability bottom line is that a building must be "Paris-proof"; that is, it must meet the objectives set out in the 2015 United Nations Framework Convention on Climate Change, widely known as the Paris Climate Agreement. Signatory nations have committed to limiting the rise of global temperatures to less than two degrees higher than those in pre-industrial times and curtailing carbon emissions to net zero by 2050.

Welling says: "To date we do not have a target at portfolio level with regard to net-zero carbon. However, in conversations we have with external managers we do challenge them to think about setting long-term targets. To date, our key condition to all real estate investments we make is participation in the annual GRESB Real Estate assessment with the aim to achieve a four- or five-star GRESB rating."

Hamilton-Grey says TH Real Estate faces similar challenges in assessing investments in different markets: "Different real estate markets around the world have different blends of sustainability certification adoption. This can be driven by both occupational market and investment market characteristics. For example, despite LEED certification originating from the US, we see a large take-up of this type of certification in Frankfurt, given the occupier base. This also sits alongside the German-originated DGNB certification and BREEAM-DE. There are significant differences between the certificates in terms of content, as some are geared towards country-specific standards, guidelines and building practices. For example, DGNB accounts for economic aspects such as lifecycle costs, whereas LEED doesn’t. Each of these certifications have certain strengths and challenges.

"Despite the presence of a wide variety of local building certification programs, internationally recognized green building certificates tend to be more widely adopted in the commercial real estate market. Tenants and investors need such standardized measures of environmental performance."

"Although we recognize the importance of design-based certification methods, we think it is also important to adopt operational certification methods"  
Richard Hamilton-Grey

New metrics
A further challenge is the growth of new sustainability metrics, such as those for healthy buildings, very much en vogue currently. For example, the International Well Building Institute offers WELL certifications for assets that provide a healthy environment for occupiers. However, APG’s Welling says he is “not a fan of single issue certification” and would like to see a more holistic approach.

Furthermore, as Hamilton-Grey notes, certification is currently linked with building design more than operations. “For TH Real Estate, the operational efficiency of a building is just as important as the designed performance of a building, since it is the operation of the building that will impact on energy usage and tenant experience, and therefore potential impact on NOI.

“Therefore, although we recognize the importance of design-based certification methods, we think it is also important to adopt operational certification methods, since it is the operation of the building that will be the true test of its real resilience on the transition to a low carbon economy.” □
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All well and good
M&G Real Estate is going beyond green to develop a sustainable investment strategy for the future. Mark Cooper talks to Nina Reid

Investment manager M&G Real Estate is expanding the focus of its sustainable and responsible property investment from green issues to look more incisively at wellbeing and the social impact of its investments. Nina Reid, director, responsible investment at M&G Real Estate, talks to PERE about this evolution in strategy for the manager’s £31.1 billion global property portfolio and the drivers behind it.

PERE: How has the role of real estate investment managers such as M&G Real Estate in sustainability evolved over the past decade; what pressures are you facing in this area?

Nina Reid: There has been a significant shift in investor interest in sustainability over the past decade. When I started at M&G Real Estate seven years ago, investors might ask: “Are you in the UN Principals of Responsible Investment?” Today investors interrogate you about your GRESB score and require specific information if that score is at the lower end of expectations. We are more frequently questioned about topics such as EPC rating, the number of green buildings in the portfolio and the overall environment, social and governance (ESG) strategy. This is only going to increase, particularly given the focus on the Taskforce on Climate-related Financial Disclosures. The larger Nordic and Dutch pension funds are leading on risk reporting around climate change, so we will get an increasing number of questions about climate change risk and how we manage that.

PERE: M&G Real Estate has relaunched its responsible investment strategy; is this in response to the changes in investor sentiment over sustainability? How does the new strategy differ from M&G Real Estate’s earlier approach?

NR: M&G Real Estate has had a responsible property investment strategy for over a decade but this was last reviewed when I first came into the role, so we took the opportunity last year to review what is happening in the market and whether our priorities were correct. During that period, not only have we seen changes in investor requirements, we’ve seen changes in occupier and legislative requirements. We are also a much more global fund manager now, so we wanted something that worked globally. We did a lot of engagement, both internally and externally and as a result of that we have our new responsible property investment strategy. We still have a very strong environmental theme, but what we’ve introduced to the strategy is measuring our socioeconomic impact: factors such as job creation, how much money does consumer spending at our retail assets put back into the broader economy? We were one of the first fund managers to look at this at a global level and we expect investors increasingly to ask about this in the future. We are in the early stages of these considerations, so our primary focus is on measurement, but the next stage will be to examine what we can do in this regard.

“We still have a very strong environmental theme, but what we’ve introduced to the strategy is measuring our socioeconomic impact…”

Nina Reid
We also have a major focus on health, wellbeing and occupier experience. M&G Real Estate has always had a strong occupier engagement program. However health and wellbeing has come to the fore over the past couple of years. Looking at how we can embed that in the design and management of our buildings is a really big change to our strategy. In the office sector, corporate occupiers are very keen on wellbeing because of its link to productivity, so they are engaged more than they were with green buildings.

We are also doing more work at our retail assets on inclusivity, making our buildings accessible to all. We have been doing a lot of training with our onsite teams at both retail and office assets. For retail, we also consider things such as, how to support people with autism. How do you support people with dementia and their carers? Small things can really improve their shopping experience and we get a huge amount of positive feedback. We’ve been rolling out, in addition to existing disabled toilets, facilities commonly called Changing Places; these are toilets for people who can’t access standard disabled toilets and have more space and the right equipment. We get a lot of positive feedback about how life changing this is for people who can now access a shopping center knowing they have a toilet they can use in safety and comfort.

These initiatives are less investor-led, but I think as we see a rise in people using the UN Sustainable Development Goals as a framework and trying to attribute a certain amount of investment to those goals, there will be more questions around job creation and other community impacts.

**PERE: How helpful are initiatives such as the UN Sustainable Development Goals, Principles for Responsible Investment and GRESB? How valuable are they to investment managers?**

**NR:** The PRI has obviously been hugely important, a ‘must have’. For unlisted real estate, GRESB is the main tool investors are using to compare performance. In many respects it has been hugely helpful because it gives us a very clear framework of activities that we need to implement, and it enables us to engage with fund managers about their strategy and key initiatives. The downside with any set benchmark is that it might miss things that are potentially really important. So at the moment GRESB is relatively light on the socioeconomic side, for example. Our focus on that doesn’t get us much credit in GRESB, although over time that could change. So these initiatives are important, but they can’t be the only tool you use to set your approach. I think you have to work out what the key risks and opportunities are for each fund and set your strategy accordingly.

**PERE: How important is it for investment managers to engage with occupiers on sustainability matters?**

**NR:** It is a mixed environment in terms of occupier engagement and interest. A lot of occupiers are concerned about sustainability at the corporate level but it might not be at the top of their mind when it comes to real estate. Wellbeing is a really interesting area because it’s the first time that I have felt occupiers are really engaged and they will become increasingly specific about what they want in this regard. They need to attract and retain staff, and they know that having buildings where people want to work is important in this. So there is a natural link. In retail, the picture is variable: some occupiers are really leading on sustainability but others are going through tough times and their main focus is the bottom line. You can tell them installing LED lighting will save them money and will have a payback in probably less than two years, but they’re not always that interested.

**PERE: Will there be an increased need for sustainable financing in the real estate sector?**

**NR:** There will be a growing need to finance improvements in a way that real estate is perhaps not used to. For example, to meet the carbon reduction targets set out in the Paris Accord, that is going to require significant amounts of capital improvements which may not have been factored into investor thinking. There are also technological factors: how is the property world going to adapt to electric vehicle charging points? If you need capacity you’re probably going to have to get battery storage onsite. If real estate owners want to own batteries, how will they invest in that? M&G Real Estate last year launched an Impact Financing Fund, a debt product that is very much focused on targeting positive environmental and social impact through its investments, which can include real estate.

**PERE: For a global investor like M&G Real Estate, how difficult is it to integrate ESG principals across a portfolio with so many different assets in different jurisdictions?**

**NR:** There are certainly difficulties, but consistency is much higher than might be expected. For example, our Asia fund invests in core institutional properties, so actually the assets have Green Building Certification, generally pretty high environmental standards and run community programs at retail assets. In almost every market, legislation is driving up energy efficiency. The wellbeing discussions are penetrating at the core end of the market. We would still like more consistency globally though. 

Reid: major focus on health, wellbeing and occupier experience
Navigating the ESG maze in developing markets

Sustainability is as much a part of the investment mandate for developing markets as it is for the more mature economies, but the type and extent of ESG policies may differ. By Arshiya Khullar

Since completion last summer, Palácio Tangará has become one of Sao Paolo’s most luxurious hotels; a sprawling urban retreat located at the center of Burle Marx Park, a vast expanse of dense Atlantic rainforest.

The story behind what it took to complete this redevelopment project, undertaken by the New York-based private equity real estate firm GTIS Partners in 2013, is also a case study in sustainability. The land was previously being built for residential use, but construction work was eventually abandoned. That, combined with the surrounding native tropical forest, meant GTIS had to deal with how to get rid of the wildlife invading the property. The firm engaged the park’s operator and the neighboring community to develop what its executives call an organized approach to safely capture the animals and move them out.

**Sustainability is integral**

Environmental, social and governance policies form an integral part of GTIS Partners’ investment strategy in Brazil, Josh Pristaw, the firm’s co-founder and senior manager director, tells PERE.

“We did not just do it because we were looking for points in a survey. We did not want to run the risk of [getting] an injunction to stop construction,” he says, explaining the sustainability efforts taken with the hotel.

“People often underestimate this issue in emerging markets, but it is true that a lot of people get into trouble with projects with things they don’t control or understand. Brazil has sophisticated laws about the environment and labor. I can give you examples of companies that have had issues with labor authorities or received fines because the wood installed was illegally harvested in the Amazon rainforest.

“Our [ESG] effort is to our benefit because it helps us save costs, attract great tenants and comply with rigid guidelines and regulations.”

Investment managers globally are embracing ESG-compliant investment strategies and the developing markets-focused firms are no exception to the trend. There is increasing demand from investors and corporate tenants for sustainable buildings in places like Brazil, China and India, but the scope and nature of how ESG policies are implemented may vary in each market.

GTIS, for instance, has developed six LEED certified office towers in Brazil in the past 10 years. Pristaw says having an ESG focus has helped in leasing commercial space to global multinational companies with a sustainability policy. The firm is now going a step ahead and exploring the possibility of developing rooftop solar systems at its industrial distribution centers in a bid to reduce the cost of power.

“If we can reduce their [tenants] operating costs, we can potentially charge more rent. We make more money and they save money. It is good for everyone,” Pristaw says.

Changing mindsets

For any new investments made globally by Allianz Real Estate, a green building certificate is a minimum prerequisite. In Asia, however, especially in China and India where Allianz is an active investor, every asset may not come with such certification, and so the investor factors in the cost of getting one in their deal underwriting, explains Rushabh Desai, the firm’s Asia-Pacific chief executive. The office asset in Beijing acquired by Allianz in July for around $185 million at a
core-plus yield, for example, did not come with a green label, but the firm has plans to undertake the relevant asset management work to get the certification.

In Desai’s view, there is a gradual change in the mindset towards adopting sustainable investing practices in these growth markets.

“The main reason why companies moved to China and India was because they found it cheaper than having an office in Hong Kong or Singapore for instance. There was a cost arbitrage, and so the owner or developer of buildings did not feel the necessity of putting in more money to get a certificate. But these markets have developed to a level that cost arbitrage is not the only reason; there is a consumption, growth and talent pool story. We expect more developers will be able to spend money to make their buildings green and still offer attractive rents.”

Watch out for a standards gap

Even then, international firms need to be alive to the gap between the local green certificates in some markets and the global standards for sustainability.

“Some of these local level certifications are not too detailed. So, as a long-term investor we factor in the cost of getting a global certification. In the years to come, national and local standards would hopefully match global standards and we won’t need two certificates for the same building, but that is a process of evolution,” Desai agrees.

Indeed, embracing ESG also works as a defensive strategy in markets like China. An office building’s favorable sustainability rating can help managers command a premium price, once it is put on the market.

“It may not make sense to make a building LEED platinum, but building an asset that has all the characteristics of a LEED silver, gold or even certified, makes good sense,” says Tom Miller, head of development and regional sustainability officer for Asia, at the Chicago-based investment manager LaSalle Investment Management, explaining the firm’s ESG policy in China. “It is a downside protection against the asset turning into a Grade B product if suddenly potential purchasers enhance their ESG requirements.”

LaSalle has made several logistics investments in China in the past few years and these too have a sustainability play.

“Whether or not a certification helps or hurts [in logistics], we don’t know yet. But given the competitive environment, new modern warehouses being developed are incorporating more sustainable features, including energy-efficient fixtures and fittings,” he says.

“People often underestimate this issue in emerging markets, but it is true that a lot of people get into trouble with projects with things they don’t control or understand”

Josh Pristaw

Realistic goal

Efforts being made by these firms and their peers is proof that sustainable investing is an achievable goal in developing countries. In the 2018 Global Real Estate Transparency Report published by property services firm JLL in June, countries like Vietnam and South Korea stand out for the progress made in sustainability transparency. With implementation of mandatory minimum energy efficiency standards for all new buildings and major retrofits, Vietnam has now entered the low transparency tier in JLL’s sustainability sub-index.

At the same time, industry observers also admit the nascent stage some of these markets are in, from a sustainability point of view, makes the formulation of appropriate investment strategies more complex. As one manager explains, the trick is to go a little ahead of the market, but not too much, with ESG implementation and the resulting increase in rents, in the hope that the strategy proves to be a return enhancer when the asset is ready to be sold in a few years.

Tracking sustainability

South Korea and Vietnam stand out for their progress in sustainability transparency, but other emerging and developing markets score unfavorably.

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Source: JLL Global Real Estate Transparency Index 2018
How real estate’s sharing economy drives sustainability

Gaw Capital’s Humbert Pang explains why the growing co-living and co-working trend is promoting efficiency and wellness.

By Mark Cooper

The emerging real estate sectors of co-working and co-living are among the hottest in the market and Hong Kong-based Gaw Capital Partners has invested in two operators in the Asia-Pacific region. It was an early investor in high-end co-working brand naked Hub and invested in Chinese co-living operator Harbour Apartments last year. Humbert Pang, managing principal and head of China at Gaw Capital Partners, talks about how these new sectors meet stakeholder demand for environmental and social sustainability.

**PERE**: What is driving the demand for co-living and co-working spaces in Asia-Pacific and China in particular?

**Humbert Pang**: Over the past 30 years or so, technology means we have progressed from an office space that needs to accommodate a large computer, filing cabinets, a fixed-line telephone and a fax machine to a situation where you can do everything with a laptop and a mobile phone. These developments mean people are fundamentally rethinking what they need from office space. At the same time, another historic major space in the office was the meeting room, but this was probably the most underutilized space in the building, maybe only full twice a year. But you still need to mingle, to interact, so you need shared space. A co-working space means you can get a hot desk, a meeting room when you need it and a social space to meet colleagues and other people.

At the same time, co-working could offer cost-saving advantages as compared to traditional office spaces, since fit-out is no longer required. This is especially attractive to SMEs and start-ups that are cost sensitive. For some location-sensitive large corporates, this cost-saving advantage of co-working could allow them to allocate more staff to prime CBD locations, where the costs of renting a traditional office could be very high. Furthermore, as more people work freelance, they are demanding shared space, because working from home is often impractical and sometimes lonely.

There is a huge demand for co-living spaces in China’s major cities. There are 7.9 million graduates each year heading to big cities to find work. They can’t afford to buy and they might also find the big city lonely and intimidating. Harbour Apartments offer solid mid- to high-end accommodation at a reasonable price. Tenants have less personal space but shared TV rooms, kitchens and other common areas, so it’s an extension of their university dorms and the opportunity to be part of a community. And with both naked Hub and Harbour Apartments, the more they grow, the larger and stronger the community is. A key to their attraction for tenants is that these are people-centered businesses; it is not just the provision of space.

**PERE**: How are co-living and co-working facilities more environmentally sustainable than ‘conventional’ office and residential space?

**HP**: The key is that co-working and co-living support the sharing of space, supplies and resources. Technology breeds efficiency and that cuts down on some basic wastefulness. For example, consider the fit-out work that would have to be undertaken by small, growing companies if they used traditional office space; they could be moving or remodeling repeatedly as they grow. Co-working space is centrally fitted
out and designed to accommodate expansion, so that is already a big saving. In a normal office, there is a lot of wasted energy in meeting rooms as they are often empty and yet often still have the aircon running. Co-living is the same because there is less waste from construction and renovation and most importantly, lower energy use from shared facilities. Think of the reduction in energy costs if you have 20 people watching the football in a TV room rather than on 20 separate televisions in their own apartments. Co-living and co-working space is also flexible and so gets worked harder; for example shared spaces can be used for events after the working day is over.

Co-working and co-living also lend themselves well to conversions of older space. In China’s larger cities we see buildings that are well located but very out of date, such as one-star hotels, which can be converted and revitalized. The simple act of converting space rather than demolishing and rebuilding is greener and also brings more life to a district. Another Gaw project, the refurbishment of Pacific Century Place in Beijing, turned an older department store into a stylish office location, with naked Hub as a tenant, and brought in new F&B outlets, which have a customer base already from the co-working members.

**PERE: As real estate investors take a more nuanced approach to ESG matters, social sustainability and community are focused on like never before; this must be a strong point for co-living and co-working?**

**HP:** In traditional office and housing spaces, people often do not know who their neighbors are, but co-living and co-working promotes community by offering platforms for people to come together and interact with each other face-to-face. In co-working spaces, the people sitting next to you change every day and in both co-working spaces and co-living apartments, the operator will organise social activities on regular basis. A report from Emergent Research last year found that 87 percent of co-working facility members report they meet other members for social reasons, with 54 percent saying they socialize with other members after work or at weekends. Plus, 79 percent said co-working has expanded their social networks and 89 percent say they are happier.

**PERE: Another rapidly developing aspect to ESG considerations is health and wellness, how does co-living and co-working meet these aspirations?**

**HP:** Wellness is a major focus for naked Hub; its co-wellness concept allows members to book activities through its mobile app for meditation, yoga, personal training, spinning, Pilates and even massage sessions. Shared spaces in the facilities run pre-work yoga sessions. So more people are actually getting into healthy habits because of the ease of going to the gym or the ease of doing those yoga classes as well. There is also a partnership with Mobike, which reduces the cost of bicycle hire and therefore encourages people to take a more healthy transport option.

Also, the community benefits of co-working and co-living are also health benefits; if people are less isolated, are happier and more outgoing then they are also healthier.

**PERE: For Gaw Capital and its investors, sustainability has to pay its way, how do the sustainable aspects of these investments boost returns?**

**HP:** A lot of the efficiency factors we’ve talked about benefit the bottom line: operators can take longer leases, there is less ongoing refurbishment work, less major capex and potentially extending building life, all of which will boost returns. Furthermore, the added value services that operators offer – such as social events, talks, classes and other events – are also additional revenue streams. Our communities are growing groups of consumers of interest to brands; operators can use big data to exploit this to the benefit of both tenants and profits.

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**Space sharing in Asia**

Gaw Capital has got ahead of the pack in investing in a growing trend

Gaw Capital invested in naked Hub in 2016 to help the co-working company boost its presence in China and the rest of Asia. Founded by husband and wife team Grant and Delphne Horsfield in 2015, the company now has 46 locations in 10 cities across four countries in Asia. Earlier this year, WeWork – the world’s largest co-working operator – announced that it was to buy naked Hub for a reported $400 million.

Harbour Apartments was also founded in 2015 by entrepreneur Huang Haibin, who rapidly expanded into seven Chinese cities: the first-tier cities of Shanghai, Beijing, Shenzhen, and Guangzhou, as well as East China’s Hangzhou and Nanjing, along with Hong Kong. The platform aims to open and operate 80,000 units by 2019. Gaw invested in the operator earlier this year. The company’s strategy builds on the Chinese government’s desire to build a rental housing market in China, in order to provide good accommodation for young workers in major cities and to reduce speculation in the housing market.
No longer a distant thought
Is it possible to have good portfolio diversification within a sustainable framework?
A new Reitsmarket index shows it is, writes Tim Vanvaerenbergh, partner at Reitsmarket

The strong growth in REIT investing has been enabled by several attractive investment characteristics offered by listed real estate companies. They ensure a regular and predictable income stream through the distribution of above-average dividends. Also, the effect of annual capital gains through higher share prices should not be underestimated. Second, a portfolio of REITs has exposure globally to different segments within real estate – offices, logistics, retail, retirement homes and residential – and also benefits from the specialized management teams in charge of the companies. Lastly, as an alternative asset class, real estate has a reduced correlation with more traditional investments in equities and bonds. The global real estate market does not follow variations in stock or bond valuations slavishly and is therefore seen as an excellent diversification for an investment portfolio.

Sustainability comes to the surface
It is indispensable for a well-diversified portfolio to have an allocation to listed real estate. From an implementation point of view, this is not a straightforward task given there are more than 2,500 real estate companies listed worldwide. In their new index, Reitsmarket selects REIT companies based on a low-risk profile and high earnings forecasts, which translates into a diversified and performing portfolio.

But for an increasingly large group of private and institutional investors, achieving only good risk-returns is no longer sufficient. They are looking for investments in companies that are also aware of their environmental and social responsibilities. Investors strive more and more for ethical allocations that take into account well-defined ESG criteria.

A sustainable real estate index
Until now, the investment world lacked initiatives that connected real estate and sustainable investing. The Euronext Reitsmarket GRESB Global Sustainable index is an exception to this.

How is this new index composed? As a first step, the global REIT universe is passed through a screening that verifies whether companies communicate and report in a sufficiently transparent manner around sustainability. To perform this screening, Reitsmarket is partnering up with GRESB. The sustainability screening focuses on the ESG awareness and transparency of REITs and examines each company on the availability of public reports and certificates regarding energy and water consumption, waste policy, renewable energy, stakeholder engagements and many other aspects. In other words: who communicates what and who is active in creating transparency around ESG factors.

After the GRESB screening, a globally diversified sub-universe of more than 200 sustainable REITs remain as eligible index constituents. This exercise is repeated annually. Given that real estate companies are increasingly becoming aware of their environmental and social responsibilities, the list is growing each year.

After screening, Reitsmarket selects 30 real estate companies for the Euronext Reitsmarket GRESB Global Sustainable index through quantitative and algorithmic methodologies. On the one hand, Reitsmarket examines quarterly figures of REITs to identify companies that are undervalued and link financial health to above-average earnings growth. On the other hand, more market technical factors, such as return expectations and various risk factors, are also taken into the equation. REITs with a low risk profile are clearly preferred in the selection. This procedure is repeated quarterly in order to respond dynamically to changing market conditions.

The whole methodology is completely systematic, which allows the construction of specialized indexes that aim to outperform the general real estate market. The end result is an investment in globally diversified real estate that offers good portfolio diversification within a sustainable framework.

200+
Number of REITs eligible as index constituents after GRESB screening

“Investors strive more and more to ethical allocations that take into account well-defined ESG criteria”
Tim Vanvaerenbergh
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