Time To Take ESG Seriously

Mounting ESG regulations and industry pressures are pushing real estate managers to adopt evolving best practices

OVERVIEW

There's no avoiding the incoming Environmental, Social, and Governance (ESG) wave. Demands for greater ESG disclosures and action are rising globally, especially in the United States and Europe. These pressures are coming not only from government agencies but also from real estate industry groups in the form of reporting guidelines, as well as simple peer pressure. Real estate managers need to take ESG seriously and adopt best practices to keep their portfolios competitive.

ESG HISTORY

In its modern incarnation, ESG began with growing environmental awareness in the 1970s, and then broadened to also include social issues in the 1990s when activists encouraged corporations to adopt a "triple bottom line" business strategy that considers People and the Planet in addition to Profits (also referred to as "PPP"). This concept evolved again in 2006 to include governance when the United Nations launched its Principles for Responsible Investment (UNPRI) reporting framework.

The UNPRI seemed more aspirational than realistic when it was first proposed, but its principles have become mainstream business practices less than two decades later. Still, these guidelines are far from universally adopted. Many firms continue to dodge or delay their implementation despite many studies that demonstrate how ESG practices can boost bottom lines – in addition to creating goodwill for the firm and doing good things for the environment and the community. However, a growing number of industry reporting frameworks and government mandates mean these holdouts will not be able to resist action much longer.

HEAVYWEIGHT INDUSTRY GROUPS WEIGH IN

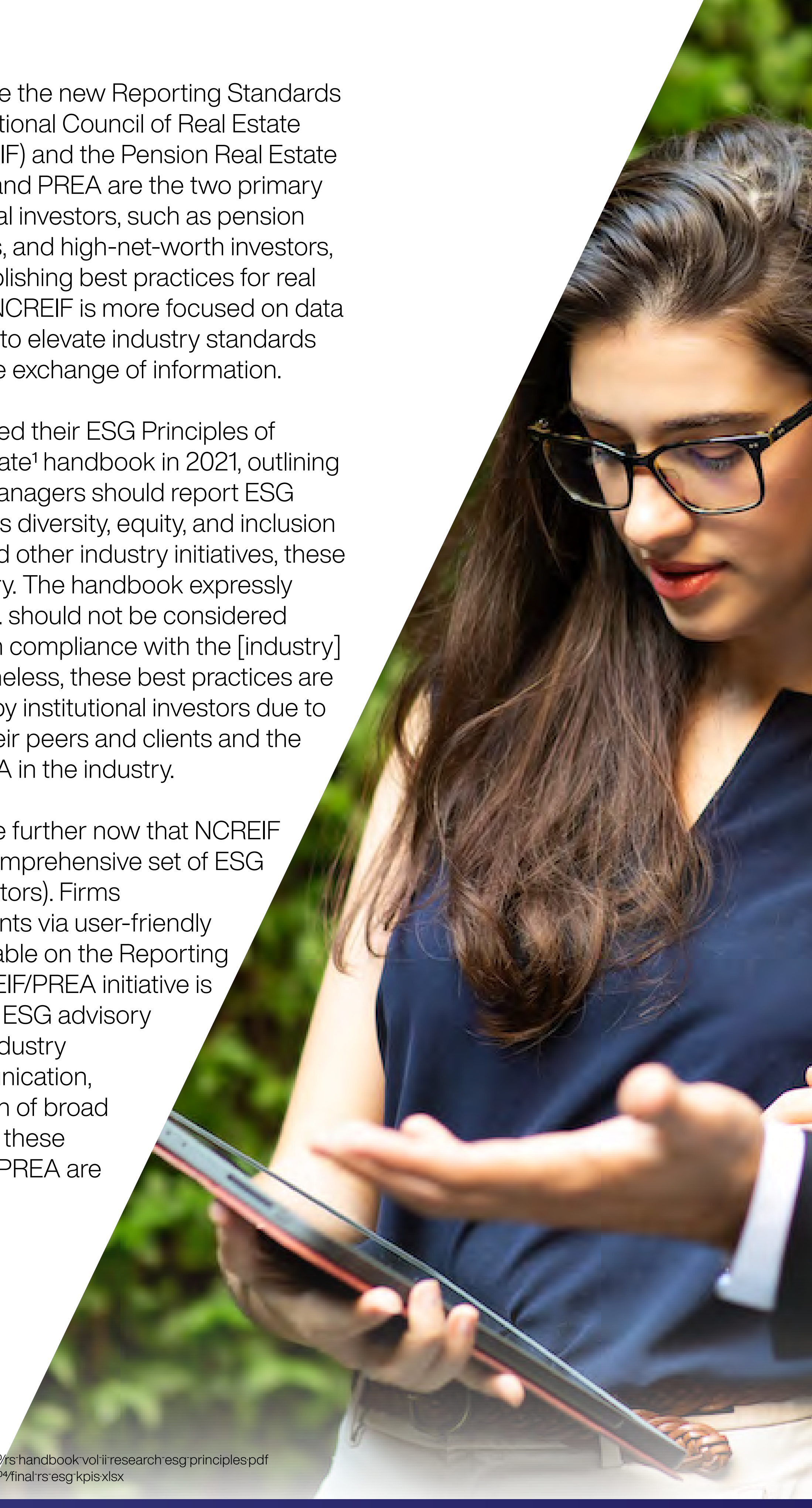
The primary drivers of ESG reporting disclosures are not government mandates but encouragement from industry itself. On the environmental side, for example, many builders and property owners were quick to participate in nonprofit programs such as the U.S. Green Building Council (which developed the LEED building rating program) and the ULI Greenprint Center for Building Performance (which aims to reduce carbon emissions). Many leading corporations routinely issue sustainability reports that initially focused on measuring environmental impacts and quantifying mitigating actions but now increasingly cover social and philanthropic programs.

Though all these efforts are purely voluntary, they have been widely adopted throughout the real estate sector. One key reason: competitive market pressures from tenants, clients, and investors who want to feel good about the firms they do business with. But now there's another compelling reason: their competitors are banding together to pressure firms to disclose their ESG impacts.

Perhaps most influential will be the new Reporting Standards initiative sponsored by the National Council of Real Estate Investment Fiduciaries (NCREIF) and the Pension Real Estate Association (PREA). NCREIF and PREA are the two primary industry groups for institutional investors, such as pension funds, sovereign wealth funds, and high-net-worth investors, and play leading roles in establishing best practices for real estate investment reporting. NCREIF is more focused on data standards, while PREA seeks to elevate industry standards more broadly and facilitate the exchange of information.

NCREIF and PREA jointly issued their ESG Principles of Reporting for Private Real Estate[1] handbook in 2021, outlining how real estate investment managers should report ESG impacts and actions, as well as diversity, equity, and inclusion (DEI) efforts. As with LEED and other industry initiatives, these principles are entirely voluntary. The handbook expressly notes that "these principles . . . should not be considered requirements in order to claim compliance with the [industry] Reporting Standards." Nonetheless, these best practices are bound to be adopted widely by institutional investors due to competitive pressure from their peers and clients and the influence of NCREIF and PREA in the industry.

Adoption is likely to accelerate further now that NCREIF and PREA have released a comprehensive set of ESG KPIs (Key Performance Indicators). Firms can complete their assessments via user-friendly spreadsheet templates[2] available on the Reporting Standards website. The NCREIF/PREA initiative is also planning to form a global ESG advisory board/think tank with other industry associations "to forge communication, prioritization, and collaboration of broad strategic plans for ESG within these groups." Indeed, NCREIF and PREA are hardly alone in promoting ESG reporting.



[1] https://reportingstandardsinfo.files.wordpress.com/2021/10/rs-handbook-vol-ii-research-esg-principles.pdf
[2] https://reportingstandardsinfo.files.wordpress.com/2022/04/final-rs-esg-kpis.xlsx

IT'S A GLOBAL TREND

This NCREIF/PREA initiative plan highlights that ESG reporting is not limited to the United States but is taking root around the world. In fact, often Europe has led the way with elevated environmental practices, well before the US. The leading European real estate industry group is INREV, short for the European Association for Investors in Non-Listed Real Estate Vehicles. Similar to its U.S. counterparts, INREV[3] aims to "improve transparency, professionalism and best practice across the sector, making the asset class more accessible and attractive to investors."

Promoting ESG is a major goal, and INREV has established its own Sustainability Guidelines[4] for reporting ESG implementation. But unlike in the U.S., these "guidelines" will be mandatory for all member firms. While 2023 is a transition year for assessing needed organizational changes, the reporting guidelines will become mandatory starting in 2024, though INREV recommends full adoption as soon as possible.

Real estate investing is a global business, and most CRE professionals own assets in different regions around the world. With ESG continuing to elevate in importance globally, there will be no avoiding industry reporting standards, even if the standards vary by region or country. Owners will need to assess their portfolios regularly and take appropriate measures to ensure compliance wherever they own property.

[3] https://www.inrev.org/about-inrev
[4] https://www.inrev.org/guidelines/module/sustainability-2023#inrev-guidelines

GOVERNMENT REGULATIONS

For all the societal concerns with reducing environmental impacts and promoting social justice, governments have been surprisingly slow to mandate ESG reporting, particularly in the United States. That's changing now. The Securities and Exchange Commission (SEC) proposed ESG disclosure regulations in May 2022 "to promote consistent, comparable, and reliable information for investors concerning incorporation of . . . ESG factors."

The proposed regulations would not cover all firms, but as with the reporting principles being sponsored by private industry groups, these disclosure requirements could set de facto industry standards due to the dominant market share of the entities that are covered. The regulations would apply to "registered investment advisers, advisers exempt from registration, registered investment companies, and business development companies." These would include REITs, which are not part of the NCREIF/PREA initiative. Moreover, green building funds and funds specializing in social investing would be subject to additional reporting requirements.

Regulations in Europe are even stronger and were already enacted on January 5th, 2023. The European Union's Corporate Sustainability Reporting Directive (CSRD)[5] "requires all large companies and all listed companies (except listed micro-enterprises) to disclose information on their risks and opportunities arising from social and environmental issues, and on the impacts of their activities on people and the environment." In simple terms, about 50,000 firms will eventually need to disclose their ESG impacts and actions starting in the 2024 fiscal year. The effective date is staggered based on various criteria, but all firms will be covered by 2028. Importantly, the law applies to not only EU-based firms but also non-EU firms that meet certain thresholds.

[5] https://finance.ec.europa.eu/capital-markets-union-and-financial-markets/company-reporting-and-auditing/company-reporting/corporate-sustainability-reporting_en

THE IMPORTANCE OF STAKEHOLDER ENGAGEMENT

A key element of ESG is assessing how property managers and owners engage with their stakeholders, especially their tenants and employees. To that end, regular employee and tenant surveys are essential for engaging with these constituencies, gauging their interests and actions, and getting buy-in for sustainability initiatives. KingsleySurveys is a trusted industry partner, helping CRE clients measure stakeholder engagement for 35 years.

As GRESB points out, "landlords and property management companies can make good use of effective tenant engagement to disseminate sustainability-related information and attain continuous improvement of the occupancy's environmental, social and governance performance."[6]

The new reporting frameworks from the NCREIF/PREA reporting initiative and INREV, as well as the EU's new sustainability reporting directive, all incorporate similar topics, even if the metrics and measurement methods vary for each framework. However, as with GRESB, stakeholder engagement is an essential feature of all these reporting frameworks, as is the need for regular surveys of key consistencies. KingsleySurveys also provides the reports these organizations require, making it easier for clients to verify the results of their engagement initiatives.

[6]https://www.gresb.com/nl-en/tenant-engagement%E2%80%93the-road-to-corporate-sustainability/

THE FUTURE IS NOW

All of these developments mean that building owners and managers cannot afford to delay their own ESG benchmarking. Even if disclosures and reporting are not yet explicitly required for your portfolio in your specific jurisdiction, that day is soon coming. In the meantime, owners and managers will feel the competitive heat to act as investors, tenants, employees, and other stakeholders increasingly demand to know that their business partners are doing what they can and should for the environment and society. In fact, tenants who have their own corporate ESG or environmental goals will proactively seek properties that support their brand or declaration. CRE owners who do not take ESG seriously could lose tenants or put off others with similar convictions. While some political groups recently have pushed back against ESG initiatives, which could slow its adoption, corporate and public support remain strong, providing momentum for growing acceptance.

Some industry participants speculate that these initiatives and requirements would be deferred if the economy slows or enters a recession. Don't count on it. Sustainability skeptics expressed similar views about "green buildings" during the Great Financial Recession that began at the end of 2007 – just as sustainability was beginning to take root in the real estate industry. Instead, the opposite happened. Major developers and building owners embraced sustainability as a way of differentiating their buildings during the downturn, and the number of buildings certified as LEED soared and became the new standard for Class A buildings for institutionally-owned real estate.

Short of a full-scale depression, no economic slowdown this year is likely to suspend industry-wide adoption of ESG. Is your organization ready?

CONTACT OUR CRE EXPERTS TO DISCUSS HOW KINGSLEYSURVEYS CAN SUPPORT YOUR ESG STRATEGY!