Sustainability in Real Estate portfolios

Explore the risk of value loss due to stranded assets and show ways to a profitable and sustainable real estate portfolio.

The world's stock of buildings is responsible for almost 40% of global carbon emissions. Experts from J.P. Morgan Asset Management, Almazara Real Assets Advisory und Avida International discussed how global real estate can be made more sustainable in a webinar. What steps are needed to lower the risk of assets becoming stranded assets and owners making substantial losses?

Greener buildings are financially attractive

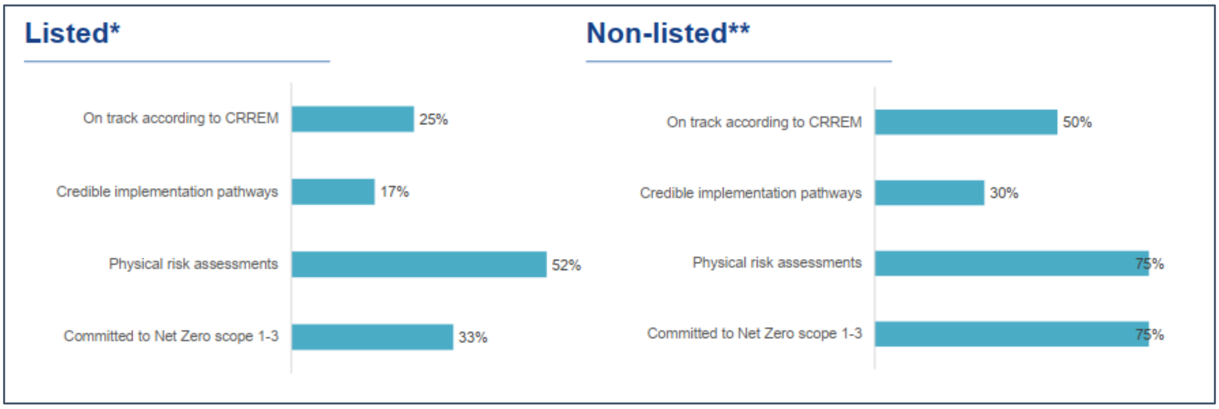
Professor Piet Eichholtz explained why even a climate sceptic should be considering investing in greener buildings. There's a body of evidence emerging about the financial benefits of greening buildings, mainly from academic studies of the residential and office sectors. Studies carried out before the energy crisis, confirmed that more energy efficient buildings generate a significant rent premium for both residential and commercial property averaging 6% as well as considerably higher occupancy levels. Eichholtz concluded that the research to date, implies green real estate is more liquid, less risky, enjoys higher market values and benefits from lower costs of capital.

Real Estate funds are not on track to achieve Net-Zero by 2050

Climate risk is not only an environmental but also a major financial risk argued Almazara's Bas van den IJssel. Achieving Net-Zero should be seen as a commercial priority rather than a policy "extra". Climate change will impact real estate performance and investor and occupier demand. Research is demonstrating that sustainable real estate has higher values and is less at risk of becoming stranded. Green real estate achieves significant rent premiums and has lower energy and water usage.

Nonetheless, real estate funds are not on track to achieve Net-Zero before 2050 according to the findings of the GREEN platform.[1] Therefore, active ESG management is necessary to achieve the Paris targets. This requires consistent ESG policies, a Net-Zero roadmap and active asset management. Institutional investors must integrate sustainability due diligence into their investment processes and monitoring. Due diligence in the investment phase is not enough on its own. Active ownership is a vital part of ESG policy, with active engagement being an essential element in preventing the risk of stranded assets.

Chart: Status of the Sustainability plans of Real Estate Funds



Source: GREEN-Engagement Report based on data concerning REITS in the FTSE/EPRA/NAREIT universe, as well as 19 non-listed funds with a total combined AuM of >$130 billion spread over US, Europe and APAC.

The sustainability challenges of different fund risk profiles

Core and non-core real estate funds present different portfolio and asset management challenges according to Dr Paul Kennedy of JP Morgan Asset Management. Core and non-core strategies present distinctive challenges for managers according to fund characteristics like risk structure, asset holding period, duration, target returns, fees and operating costs. Core real estate funds are mostly open-end funds with a long asset holding period and relatively low fees and operating costs. Non-core real estate funds aim at higher returns, depending on underlying risks. They are often closed-end funds with comparatively short

[1] The GREEN engagement network was set up for institutional investors in real estate and aims to ensure the industry reaches the Paris goals on climate change and engages real estate managers about their environmental performance. It is intended as a cost-efficient way to bundle knowledge and communicate with managers.

asset holding periods for each individual investment. For all risk categories the focus is on using ESG strategies to continuously work towards achieving climate neutrality in real estate.

The first step towards this goal is improving assets through measures like improved data provision, energy optimisation and PV provision for core assets. For non-core assets, managers focus on substantial asset redevelopment and re-positioning, which can include high performance glazing, natural ventilation, capital expenditure on thermal improvement and zero use of fossil fuel energy.

Net-Zero needs engagement by asset owners

Despite emerging evidence illustrating the benefits for occupiers and owners of sustainable real estate, real estate funds are behind schedule in achieving Net Zero by 2050. As Dr Paul Kennedy outlined, it's possible to improve existing assets to meet the challenge of lowering emissions. However, managers that fail to adapt their buildings and portfolios are at risk of their assets becoming stranded. Dr Dorothee Franzen from Avida International concludes: "Asset owners need to step up their engagement efforts to convince managers to adopt the best market practices, better climate risk management strategies and target reducing emissions. It's evident that engagement is a vital component of effective active asset ownership, but it requires appropriate resources and skills. Professional consulting and joining forces with other institutional investors can provide the necessary support." Clearly, after the summer that much of Europe has just experienced, the need for more collaborative, effective engagement in the real estate sector has never been more urgent.

Link to Webinar

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