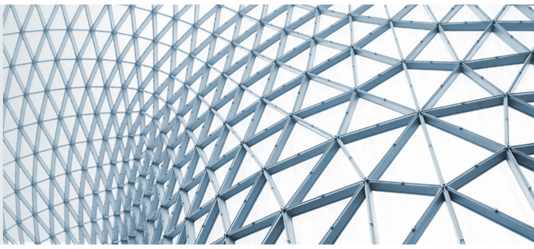

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Next-generation real estate

Rapid evolution in sustainable buildings raises the bar for property investors

Key Takeaways:

- Sustainability in real estate is advancing rapidly and investors need to adapt in order to future-proof their assets. Future-proofed buildings are regarded as higher-quality assets by many tenants, who assess that the green asset of today will be a standard asset in a few years.
- Continuous ESG measurement helps ensure real value is being created.
- ESG measures are not standardised in real estate and to anticipate future norms investors need to partner with real estate advisers with deep experience and a record of innovation

For some asset classes, sustainability is a nebulous concept: it is difficult to identify, hard to measure and nearly impossible to value.

Not so for buildings. The sustainability of buildings is both tangible and measurable. It is highly visible too, with some sustainable buildings so striking they have obtained the real estate equivalent of rock star status.

Take the Cambridge Central Mosque, the UK's first "eco-mosque", which can host up to 1,000 worshippers and is made of sustainably sourced wood and low-carbon materials. It is powered entirely using locally-generated renewable electricity.

Or ArcelorMittal's flagship complex in Ghent, where the 27,000 solar panels on the roof generate 10,000 MWh a year. Or Deloitte's Amsterdam headquarters "The Edge" which resembles a giant glasshouse and is covered in a solar film which powers the office's ethernet-connected LED lighting.

Then there's SEAT's facility outside Barcelona, which has 30,000 sqm of self-cleaning and pollution-trapping pavements.

No wonder investors like sustainable buildings. They are not just low-emission and low-carbon, they are eye-catching and give investors a feelgood factor. Not all buildings need to possess such eye-catching features, but sustainability in real estate is advancing rapidly and investors need to adapt in order to future-proof their assets.

Thierry Laquitaine
SRI Director
AEW

Why is sustainability on the move?

The European real estate industry accounts for approximately 40% of the total energy consumption of Europe and around 25% of its greenhouse gas emissions.

Authorities are aware of this and are acting. France has led the way with regulation demanding that big companies report their carbon emissions in detail, but other European countries are catching up. Initiatives are being launched in both public and private domains, and at national and international levels.

Just as important as regulation in driving ESG is the desire of real estate tenants to be associated with sustainable buildings. Other stakeholders, such as service providers, local residents, workers and local authorities are also increasingly making their voices heard to demand that asset managers incorporate robust ESG criteria into buildings.

Some institutional asset owners have a long history of investing in real estate

and are aware of these changing demands. They have typically adopted a risk-based approach, not only complying with current rules, but anticipating future rules and laws.

Experience tells them that waiting until the last minute before implementing regulatory or legal requirements is a false economy. The cost of implementation is likely to be higher later on as services and processes have to be re-engineered at high cost and maximum disruption to tenants. Integration of ESG measures at each stage of the build and fitout, however, reduces costs and maximises savings.

Green buildings also attract more and higher-quality tenants. A growing number of tenants demand the greenest building possible, complete with certifications and labels. These proofs of sustainability offer prestige to owners and tenants as well as providing a healthy working environment for employees.

Energy efficiency can help to develop the relation with the tenants and to retain them, as it is a joint effort to reduce the consumption and they directly benefit from it. It also improves buildings resilience to energy cost increase and to climate change impacts.

Best practice ESG in construction

Sustainability comes in many forms. The key to creating sustainable buildings is to consider their specific context. That is, the geography, the topology, the size and use of the building and many other factors besides. Taking these specific factors into consideration for each building, it is possible to prioritise the features that are most effective in reducing greenhouse gas emissions, energy consumption and the use of non-renewable materials.

The focus of ESG efforts is typically on the insulation of the building and the efficiency of the services such as cooling systems, heating and ventilation. But construction materials are also important: in fact, the manufacturing and construction of a building accounts for about 60% of greenhouse gases over the life of the building. Greater use of renewable materials such as reclaimed wood can reduce carbon emissions.

Meanwhile, contractors are hired not only for their ability to complete projects on time and to specification, but for their SRI competence. "We have an extensive selection process for our service providers to ensure compliance with our SRI policies," says Thierry Laquitaine, head of SRI at AEW, the real estate affiliate of Natixis Investment Managers.

Asset owners can also advise tenants on best practice behaviours inside the building to control how resources are used, further improving sustainability.

AEW applies innovative technologies across its real estate portfolio. These include geothermal technologies, cold storage systems, ground-coupled heat exchangers, data management, energy performance contracts, and software applications that measure ESG performance in buildings.

Louis XIV – the green King?

The French national theatre was built in Paris's 6th arrondissement in the 17th century by King Louis XIV. Surprisingly, it was partly constructed from recycled materials from an existing building on the same site. This early example of recycling was based on the desire of the "Sun King" to cut costs rather than any thought of conserving natural resources. Nevertheless, much of the existing wood frame was reused. So when AEW refurbished the building in 2019to transform offices into housing, it took a leaf from Louis's book and reused some of the existing materials. This earned the building a low carbon label award and provided the tenants with a building that is both historic and green.

Measure impact to create real value

For sustainable real estate measures to add value requires them to make a real impact. Boxticking and reporting may satisfy local authorities and regulators, but are likely to lead to deteriorating asset value. "The key is to get ahead of trends set by authorities," says Laquitaine. "Lagging current requirements risks censure and even just keeping pace with them is insufficient."

Continuous measurement helps ensure real value is being created. Laquitaine says: "We are careful to make a positive impact in everything we do." Energy meters, water meters, emissions meters and other measurement devices should be fitted in all buildings to assess where resources are used and how they can be better conserved, he says. These measurements should be accompanied by energy audits which aggregate building performance.

Hard measurements can be taken alongside softer measures such as tenant satisfaction surveys. These surveys are strong indicators of how sustainable efforts are contributing to the welfare and productivity of tenants and their staff.

Future-proofing returns

AEW is introducing climate change stress-testing as a forward-looking measure of sustainable impact. It is working with a climatologist to assess the resilience of buildings against the biggest climate risks, as identified by the latest Intergovernmental Panel on Climate Change (IPCC). These risks range from heatwaves, to rising sea levels, to heavy rain events and drought, and are assessed over the coming 20 years.

Each building's potential exposure to climate hazards is assessed and the potential impacts quantified. Impacts are assessed for the building, the tenants and other stakeholders to provide a comprehensive resilience report. The aim is to future-proof assets against climate changes, but also against changes in regulatory regimes and investor sentiment.

Future-proofed buildings are regarded as higher-quality assets by many tenants, who assess that the green asset of today will be a standard asset in a few years. In other words, green assets are anticipating future norms. The big risk is to merely comply with current norms or wait too long to improve the performance of a building.

The result could be a stranded asset, which is harder to let and may be valued at a discount. If assets conform to expected future norms, they are more liquid, able to let faster and retain more of their value.

Experience and innovation

ESG measures are not standardised in real estate and to anticipate future norms investors need to partner with real estate advisers with long experience and a record of innovation.

AEW is a pioneer of sustainable real estate investing. It is a founding member of the Green Rating system and the creator in 2009 of six new performance indicators (e.g. biodiversity, life cycle analysis, safety, etc). AEW was also a founding member in 2018 and is current president of Circolab an association of more than 70 real estate companies which promotes the circular economy.

It is also a leading company helping in 2020 to create a real estate SRI label, in conjunction with ASPIM, the French association of real estate investment companies in 2020.

AEW's development of sustainable practice has led to 17% less energy consumed across its real estate portfolios, 59,000 m3 less water consumed, 100% of electricity in commons area derived from renewable energy sources for its assets in France and 140 assets undergoing HSE compliance audits every year.

Its GRECO energy renovation project across a portfolio of approximately 150 buildings has enabled a 35% reduction in energy consumption since 2013.

"We have developed our own methodologies where industry tools did not exist and we are still developing innovative SRI tools," says Laquitaine. "If we want to transition buildings to the green economy, we constantly need new approaches and new competences."

Choose how sustainable your building is

Real estate investors have varying views on sustainability and what it means to them. To express idiosyncratic views requires advisers who can be flexible and offer innovative and tailored ESG services.

"We have the capacity to respond to all levels of ambition for ESG investment," says Laquitaine. Investor ambitions range from basic information about ESG performance, to detailed scoring, to a full consideration of ESG in the construction and ongoing performance of an asset.

The task for investors is to establish a balance between what is possible and what is viable. Capex must be balanced against the likely returns from a sustainability strategy. While most investors seek to mitigate emissions and climate change, too much upfront spending can have a negative impact on the profitability of an asset.

"Sometimes it is not worth buying an asset, because the costs of improving ESG performance to meet actual or future requirements are too high," says Laquitaine. "We always look at the cost of improving ESG performance. The asset has to be profitable."

Conclusion

Investors can be forgiven for finding it hard to keep pace with current trends in real estate – climate change data, local and regional regulation, and stakeholder demand are constantly changing the ESG matrix.

It is imperative to stay ahead of trends and employ innovative tools to implement, measure and adapt sustainable practices in real estate. Only real measures with real impact will suffice.

Do sustainability well and not only does the environment benefit, but the ongoing costs of a building fall and the value of assets rise.

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Share capital: €17,025,900
RCS Paris: B 409 039 914
8-12 rue des Pirogues de Bercy 75012 Paris, France
www.aew.com

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22 rue du Docteur Lancereaux 75008 PARIS.
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Natixis Investment Managers
RCS Paris 453 952 681
Share Capital: €178 251 690
43 avenue Pierre Mendès France
75013 Paris
www.im.natixis.com

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