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?

Tenant satisfaction: more green space can have a profound impact

> "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**

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 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.

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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?

Burman: a new ESG structure within CBRE Global Investors

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.

Whistler: monitoring and measuring impact is something that's still evolving

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. □