Can real estate investment ever be truly sustainable?

The definition of sustainability raises two key points: longevity and the minimisation of damage. We know the real estate industry causes a quantifiable degree of environmental stress; it is widely published that the built environment accounts for around 40% of the globe's CO2 emissions (World Economic Forum, 2022). Although less extensively discussed, we also know that real estate is intrinsically linked to social value and a sense of community. One fundamental aspect of this is how long a building remains beneficial to its occupier. These issues should always be at the forefront of investment decisions to achieve true sustainability. In the first section of this essay, I will address the problems preventing the industry from reaching sustainable investment. I will then explore what changes can be made and finally question who is responsible for catalysing them.

ESG is currently on everyone's mind in the industry. REITs and real estate funds are keen to demonstrate their commitment to ESG and sustainability as they are increasingly important to investors. Greenwashing contributes to prohibiting sustainable real estate investment from advancing. One reason this can happen is that ESG is currently hard to quantify, especially social impact. The real estate industry needs to address how to make this more explicit to be able to progress. Another prohibiting factor is that it is very difficult for valuers to reflect the long-term environmental and social impact a property has. Certifications such as BREEAM account for embodied carbon and WELL considers factors such as community. However, more work needs to be done on how this can be interpreted in a cash flow (RREF, 2023). Reportedly, 80% of the 2050 built environment already exists (Property Week, 2021). This shows significant need for retrofitting, which requires tenants to vacate causing rental loss. It is currently difficult to get loans under these circumstances. This is where input from the financial sector is required.

A systematic change to the relationship between sustainability credentials and valuations is needed. Sustainable real estate includes social and environmental factors as well as longevity, however the way they are measured needs to be changed to allow valuers to incorporate them. To include them in a valuation they first have to be reported correctly. This comes down to the industry finding a way to accurately measure factors such as social value and a building's whole-life carbon impact. Longevity is hard to predict and raises questions around how we plan for obsolescence and design our cities in an adaptable way. The problem with reporting signals that sustainable real estate investment still has some way to go. That being said, there is a high demand for sustainable buildings. As the market evolves investors may start to question buildings' true sustainability credentials, driving the change needed for reporting and valuations. To make the required change there also needs to be a level of government intervention to incentivise building and retrofitting sustainably. An idea that is being called for is a change to the way stamp duty is calculated, as a tool to accelerate sustainable investment (CBRE, 2023). The suggestion would be a ratchet correlating with the building's energy efficiency, which would both incentivise channelling capital into sustainable real estate and make the importance of sustainability more explicit.

Valuations and banking will be instrumental pieces of the sustainability puzzle. In response to the GFC the Basel Committee have proposed an international set of recognised standards to help prevent another crisis. As real estate valuations were seen to be part of the downfall, the framework aims to make the relationship between valuations and loans more financially and economically sustainable. This contributes to the economy and real estate market health.

Addressing greenwashing will be a fundamental enabler of truly sustainable real estate investment. There are measures being taken to improve transparency such as the SDR green labelling regime and SFDR regulations, which will also improve sustainable comparability of REITs and real estate funds

(HM Treasury, 2021). This will help investors to channel capital into sustainable real estate, and ultimately make greenwashing harder.

There is great awareness of the issues around sustainable investment within the industry. The real question is whose responsibility is it to make the change. Do the close ties between sustainability, finance and real estate make real estate an enabler of the change?

The answer is debateable. The change is starting to happen but it needs to be accelerated significantly. Real estate has the capacity to shape all our lives, it is where we live and work. Due to the magnitude of its influence the transformation should be strategic and standardised. Intervention needs to come from the government to regulate the change to sustainable investment. However, it is the industry's responsibility to make it happen. There needs to be collaboration between policy makers and the industry to make the difference. Once there is strong incentive, investors will follow. Finance has a huge role to play in this. For example, to retrofit on the scale necessary to address the climate emergency, banks need to restructure loans to be able to channel the capital into sustainable transformation of our built environment.

In conclusion, truly sustainable real estate investment still has a long way to go. Government net zero carbon targets will provide a degree of urgency to make the transition. For this to be successful, sustainable values must be embedded not only within policy, valuation and finance, but also within society. This is where the challenge lies. The property industry is driven by returns, so the only way to catalyse the shift is incentives. Financing and valuations will have a huge role to play in changing the trajectory of real estate investment. There is a growing demand for sustainable buildings with excellent BREEAM ratings, which demonstrates there is investor appetite and that this is increasingly important to occupiers. The change is underway, but to accelerate it at the pace needed the government and industry need to come together to design a future that is socially, environmentally and economically sustainable.

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