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December 2021/January 2022 • perenews.com

Real estate's race to net zero is picking up pace

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KEYNOTE INTERVIEW

Moving in the same direction

Real estate is in the early stages of ESG adoption, but there is a shared sense of urgency among its stakeholders to reduce the asset class's carbon footprint, argues Hines' Peter Epping

Real estate investors across the world are increasingly interested in responsible investment and recognize the need for action. While awareness is there, it is critical to invest time, money and people to meet sustainability targets, Peter Epping, global head of ESG at Hines and responsible for developing the firm's ESG strategy and co-ordinating it worldwide, explains to *PERE's* Alicia Villegas.

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Q What is driving ESG adoption in the real estate industry today?

Adoption is being driven by a whole host of factors, which are creating a positive feedback loop. With regards to the most pressing challenge, climate change, the world is trying to align with the science and keep temperature increases below 1.5 degrees Celsius. It's clear that we must act very decisively to transform our economies to get to a net-zero emissions state fast enough.

A transmission mechanism has now been put in motion by the regulators on different levels of public authority. At the top, you have the Paris Agreement, which is holding 196 nations to account to get to net zero by 2050 and to achieve a reduction of 50 percent by 2030. That has been worked into regulation and legislation to some extent in the countries that have adopted the framework. The EU is one of the most advanced parts of the world in this area, having just recently updated its guidelines with a program called 'Fit for 55', which is aiming to reduce emissions by 55 percent by 2030.

This is accompanied by other regulation and voluntary schemes, such as the global Task Force on Climate-related Financial Disclosures (TCFD), and investment-management specific regulation like the EU's

Sustainable Finance Disclosure Regulation (SFDR). Those frameworks have happened at time when many individual firms have started to make progress with decarbonizing their businesses. However, most firms now realize that from a legal, regulatory and reputational point of view, they don't have a choice. They must decarbonize their business, set themselves targets and start making reductions.

This is beginning to feed through to the transaction markets in real estate, where we're seeing investors underwriting assets differently. While many don't yet know all the specifics of how they will move forward and how best to underwrite net-zero transition risk, there is a high sense of awareness, and additional capex is often included.

Consultants are acquiring the necessary skills and helping investors and property firms to price in what needs to be done to decarbonize both new projects and existing buildings. So, it's a whole range of factors that exert pressure, and most stakeholders are now pushing in the same direction.

Q Are stakeholders, like investors and tenants, also pushing for assets to be more ESG-compliant?

They certainly are. As occupiers often control their space, including the energy they use – whether it's from renewable sources and how much they use, for instance – it can be difficult for the owner or asset manager to influence the ESG transition of an asset with respect to the tenant space.

There's a mindset shift now, given that many occupiers themselves have set ambitious ESG targets. They're now actively looking for a dialogue with landlords, and seek to collaborate and jointly reduce the environmental impact and carbon footprint of their space, the building frame, the building skin and building systems.

Equally, investors – not just in the transactions market when they buy assets directly, but also if they invest in funds – have a much more heightened sense of awareness of ESG factors. They want to understand how a fund is dealing with its carbon footprint and how quickly it will be reduced over time and brought to net zero. As an example, for some of our funds, we now have investors asking specifically about the carbon footprint and carbon emissions of individual assets.

Q How are US- and Asia-based investors getting up to speed with those in Europe in terms of their ESG requirements?

When I took on this role at the beginning of June, we all expected a focus on Europe in the first year of our new strategy and with our new team. But we've been surprised by how quickly North American investors – and quite a few Asian investors, especially the bigger ones – are now picking up on this topic and working their way through the different areas of ESG. There's a lot of understanding and know-how investors are still catching up on, but the awareness is very much there now. That's confirmed by the vast majority of our interactions with North American investors. Whether it's for direct or indirect investments, ESG has become very important in North America and the tone is very similar to discussions in Europe.

In a similar way, Asian investors have understood that this topic is a huge priority in Europe now, that it's quickly gaining traction in North America, and so they understand it will affect their market too. We're seeing quite a few of our Asian partners trying to really speed up and take a leading position as a new market for top-notch ESG products.

Q How is the real estate industry making progress to meet sustainability goals?

The industry is making progress, but at this stage, it's not yet as advanced as it needs to be. If there were 10 stages of ESG adoption and implementation, I'd say real estate is somewhere between two and three at the moment. Importantly, though, you'll be hard-pressed to find any firm today that doesn't have an ESG target or is not planning to implement one soon.

Pretty much everyone has understood the necessity and the urgency. Where firms differ, though, is the extent to which they already have created

capacity, appointed internal personnel to work through these work streams, and to what extent they have worked with external consultants and really understood the scale and complexity of what needs to be done to decarbonize their business and achieve strong ESG performance holistically.

My expectation is that over the next 12 to 24 months, we'll see a very significant increase in deep ESG adoption. With respect to net zero, most companies are starting in all seriousness with the implementation of their carbon reduction plans.

> *"If there were 10 stages of ESG adoption and implementation, I'd say real estate is somewhere between two and three"*

Q Your European Core Fund has been recognized by GRESB for its sustainability performance for the fifth consecutive year. How are you reaching the top of the GRESB pile?

From the beginning, we've been comprehensively pushing on the 14 different areas that make up the GRESB score. One factor that's helped our performance is that we're collaborating with our occupiers and achieving strong data coverage of occupiers' space. This collaboration has been challenging in the past because, in many situations, leases typically don't oblige occupiers to share that data, and many don't like to share this kind of data.

But as mentioned, there is a mindset shift as occupiers want to reduce their impact themselves. They realize their occupied space plays such a big role in reducing the emissions of the entire building. Due to this significance, GRESB assigned us a high scoring for our ability to get that tenant data.

Q What are you doing to make your strategy work, including updating what you have in place?

It's about the focus of our central teams on ESG, making sure there's a very deep understanding of the different topics at hand, working together with the best external sources of knowledge and know-how, and developing playbooks we use with our local teams globally. Our teams have worked very well with some of the best consultants in the world, but no matter how good a consultant may be or how strong a central team you have in your company, it's still fundamental to work in a collaborative and effective way with your local teams.

We have very strong local platforms in 27 countries. In Europe, for example, we have over 650 people on the ground. We don't just have an acquisition manager and asset manager in each of the 16 cities we're active in, we have full technical teams too. So, we have architects and engineers, which allows our central conceptual construction team and our ESG team to engage in an in-depth way with our local teams, and to implement the different initiatives in a consistent way.

That's critically important, because you need to perform not just in a few signature projects or in one year; it must be scaled across our whole business and strong performance must be repeated. GRESB, for instance, is increasing its requirements from one year to the next. So, managers need to build on their existing knowledge, continue to learn and invest.

Q Why do fund managers need to take a lead on sustainability?

The global problems we're facing are so pressing and finally forcing the market to change quickly now, both on the environmental side, where climate and carbon are the dominant topics, and on the social side, where housing is one of the biggest issues we're facing. Imbalances have built up in the market and our cities can't tolerate those any longer. That means our system, our economies, our societies are now changing. Funds and investment strategies need to adapt to a new reality.

Because these factors are so forceful and touch so many aspects of an economy, fund managers really need to make sure their strategy and buildings do not become obsolete over the next three, four, five or 10 years. They need to understand how the costs of ESG-compliant buildings are changing and what this does to rents, yields and returns.

For example, you have to build differently in order to make a building operationally net zero. In most cases, this means more upfront costs. It also typically means lower energy and overall operating costs, and being future-proofed against fines and a potential carbon tax, which could become significant cost elements in the future.

So, you can de-risk your assets, contribute to solving the big problems we're facing and in all likelihood provide a better risk-adjusted return. ■

Important Information About Risks

Investing in shares of our common stock involves a high degree of risk. You should purchase shares only if you can afford a complete loss of your investment. Please see the "Risk Factors" section of the prospectus before purchasing our common shares. Hines Global elected to be taxed as a real estate investment trust, or REIT, for U.S. federal income tax purposes beginning with its taxable year ended December 31, 2015. Significant risks relating to your investment in our common shares include:

- Our charter does not require us to pursue a transaction to provide liquidity to our stockholders and there is no public market for our common shares; therefore, you must be prepared to hold your shares for an indefinite length of time and, if you are able to sell your shares, you will likely sell them at a substantial discount.
- This is a blind pool offering and you will not have the opportunity to evaluate the additional investments we will make prior to purchasing shares of our common stock.
- This is a best efforts offering and as such, there is a risk that we will not be able to accomplish our business objectives and that the poor performance of a single investment will materially adversely affect our overall investment performance, if we are unable to raise substantial funds.
- Distributions have exceeded earnings. Some or all of our distributions have been paid, and may continue to be paid, and during the offering phase, are likely to be paid at least partially from sources such as proceeds from our debt financings, proceeds from this offering, cash advances by our advisor, cash resulting from a waiver or deferral of fees and/or proceeds from the sale of assets. We have not placed a cap on the amount of our distributions that may be paid from any of these sources. If we continue to pay distributions from sources other than our cash flow from operations, we will have less funds available for the acquisition of properties, and your overall return may be reduced.
- The purchase and redemption price for shares of our common stock generally will be based on our most recently determined NAV (subject to material changes) and will not be based on any public trading market. While there will be independent appraisals of our properties performed annually, at any given time our NAV may not accurately reflect the actual then-current market value of our assets.
- There is no public market for our shares and an investment in our shares will have very limited liquidity. There are significant restrictions and limitations on your ability to have any of your shares of our common stock redeemed under our share redemption program and, if you are able to have your shares redeemed, it may be at a price that is less than the price you paid and the then-current market value of the shares. Further, our board of directors may make exceptions to, modify or suspend our share redemption program if in its reasonable judgement it deems such actions to be in our best interest and the best interest of our stockholders. Although our board of directors has the discretion to suspend our share redemption program, our board of directors will not terminate our share redemption program other than in connection with a liquidity event which results in our stockholders receiving cash or securities listed on a national securities exchange or where otherwise required by law.
- Due to the risks involved in the ownership of real estate investments, there is no assurance of any return on your investment in, and you may lose some or all of your investment.
- International investment risks, including the burden of complying with a wide variety of foreign laws and the uncertainty of such laws, the tax treatment of transaction structures, political and economic instability, foreign currency fluctuations, and inflation and governmental measures to curb inflation may adversely affect our operations and our ability to make distributions. Because the performance participation allocation payable to our advisor is calculated based in part on changes in our NAV, our advisor may be entitled to a greater or lesser allocation even if the changes in NAV are due solely to foreign currency fluctuations.
- If we internalize our management functions, we could incur adverse effects on our business and financial condition, including significant costs associated with becoming and being self-managed and the percentage of our outstanding common stock owned by our stockholders could be reduced.
- We rely on affiliates of Hines for our day-to-day operations and the selection of real estate investments. We pay substantial fees and other payments to these affiliates for these services. These affiliates are subject to conflicts of interest as a result of this and other relationships they have with us and other investment vehicles sponsored by Hines. We also compete with affiliates of Hines for tenants and investment opportunities, and some of those affiliates may have priority with respect to certain investment opportunities.

This investment is not suitable for all investors. Please refer to the prospectus for the particular suitability standards required in your state. You should read the prospectus carefully for a description of the risks associated with an investment in real estate and in Hines Global.

Forward-Looking Statements

This material contains forward-looking statements (such as those concerning investment objectives, strategies, economic updates, other plans and objectives for future operations or economic performance, or related assumptions or forecasts) that are based on Hines' current expectations, plans, estimates, assumptions and beliefs that involve numerous risks and uncertainties, including without limitation, the risks set forth above and in the "Risk Factors" section Hines Global's the prospectus. These statements are only predictions and are typically identified using terms such as "may," "will," "should," "expect," "could," "estimate," "believe," "continue," "predict," "potential" and other comparable terminology. Any of the assumptions underlying the forward-looking statements could prove to be inaccurate and results could differ materially from those expressed or implied. You are cautioned not to place undue reliance on any forward-looking statements. We undertake no obligation to publicly update or revise any forward-looking statements.

Important Information About the Coronavirus and Global Real Estate Markets
The Coronavirus (COVID 19) pandemic has had an adverse impact on global commercial activity. Investments in real properties and real estate related securities have not been immune to the impact of the pandemic. Although the outlook is improving in certain areas of the world, including the United States, the United Kingdom, and Europe, considerable uncertainty still surrounds the Coronavirus and its potential effects on the population, which makes it difficult to ascertain the long-term impact it will have on commercial real estate markets.

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HGIT-PEREESG 12/21