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KEYNOTE INTERVIEW

The human half of net-zero real estate

Engaging tenants on ESG is still a relatively nascent concept, but net zero requires intense collaboration to carry through in practice, says Hines' Peter Epping

Despite making leaps and bounds in recent years, net zero and ESG were not always the hot topics they are now. Even if they have been talked about in different guises for some time (such as 'sustainability'), the concepts are really only a few years old, says Peter Epping, global head of ESG at Hines. As recently as 2012, it was still nascent and niche.

Now that regulations have progressed and fund managers are all actively engaged in conversations around ESG, the work is far from over. To really achieve net zero on a meaningful scale, and to reap the rewards from this, we have to engage tenants and owners in the mission. It's a challenge, but Epping tells *PERE* that the effort is well worth it on many levels.

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Q How have ESG and net zero become accepted by the real estate industry over time?
There are a few factors that have driven us and our business to pursue ESG and net zero. For one, the science has become ever clearer: we know that climate change is human induced and it's drastic and poses an existential risk for humanity. Such evidence coinciding with the pandemic has illuminated how action plans and solutions can be executed on this scale. It has also shown what happens if you delay action.

Stakeholders and investors now have a heightened perception of these issues. In their eyes, what seemed urgent from a sustainability point of view 10 years ago is no longer accurate, and the actions we used to take in response are now too little. If we keep to our same patterns, it will be catastrophic. That perspective has been taken up by the regulators in Europe and the rest of the world is catching up.

While ESG is a crucial part of the overall strategy, we're finding that because of the ticking clock we're up against, net zero is dominating the agenda. All the years the public and private sectors spent putting together regulation and working through frameworks, like the UNPRI and the TCFD, are now paying off, as they gain momentum and make a real impact on the markets.

But while the standards are not universal, there's a large proportion of the market that don't want to implement ESG or net zero unless it gives direct bottom-line benefits. However, investors are coming to realize that if they invest in a property with a long-term horizon, 10 years down the line, the next buyer will look at the asset very differently than someone today. Future buyers may only want a property that is already low carbon, or which has a very clearly defined pathway to getting there. This perspective has moved past initial societal awareness and has impacted the institutional mindset.

Q Most fund managers talk about net zero and ESG in terms of investors, returns or even regulations, but what does it mean for tenants?

There is a very broad landscape of tenants. The amount actively pursuing green goals, ESG and net zero is smaller compared to investors, but for many companies, it's about living up to what they have promised their clients – and also recruitment, because the younger generation is inquiring about these topics. We are working with some technology companies that have set ambitious targets without a deep understanding of how they can get there.

On the other hand, many tenants lack the willingness to engage with ESG, which becomes an issue when we want to make changes to achieve net zero if that leads to higher rents. Instead, many tenants are still driven mostly by shorter-term cost considerations. Having said that, we do feel that is changing. Every year, we find yet another group of tenants that are curious about ESG and express interest. There are also some big companies that have made public and ambitious promises, such as not occupying any space that is not net zero by 2030.

Q How do you engage with tenants as both a fund manager/owner and property manager, and how do you win reluctant tenants over to ESG/net-zero goals?

We engage with tenants quite closely, because collaboration is key to making a building green and net zero overall. For that reason, about 15 years ago, we released the Hines GREEN OFFICE Tenant Program, which contains a whole range of advice on how tenants can make the space they occupy greener. From avoiding waste to saving energy, we found that tenants liked the guide, and it encouraged them to discuss the options.

The biggest question we get today is around energy-saving measures. Historically, if you have large tenants, or a single-tenant building especially, they may not want to discuss changes to the building or want you involved as an owner. But now we're receiving questions from historically resistant tenants about how they can decarbonize, save energy and monitor their consumption. It's also becoming a positive talking point with other tenants and customers. We're seeing the opposite of greenwashing – something that achieves tangible results through action.

As owners, we know there is an upfront cost to making these buildings green, but since it's the tenants who

Looking behind as well as ahead

Even while building new green structures may be flashier, it's only half the solution

Even as better buildings go up, older buildings will remain, leaving the same carbon footprint. "This is where the real problem is: it's not how much carbon new buildings will emit, but rather the carbon produced by existing buildings which is much, much larger," says Epping.

The only solution, Epping insists, is to refurbish these buildings, even though it may be costly. Indeed, Hines recently acquired a set of 1930s-era buildings on Hudson Street in New York City – an excellent location, but with clearly outdated amenities. The firm will undertake a complete refurbishment, with the goal of eliminating all fossil-fuel-sourced energy and moving to geothermal for all heating and electricity. Hines' designs have won awards locally, and the firm expects to make the entire building net zero by 2032.

"The value of net zero and ESG is hard to communicate because the market is not pricing these assets correctly"

"We know there is an upfront cost to making these buildings green"

From 1930 to 2032: NYC's 345 Hudson Street is on a net-zero journey

get the direct benefits, we also want a dialogue with them. It takes honest discussion and collaboration to see where we can add a small amount back to the rent, because in the long run that will make the property more valuable to the owners and the tenants.

Q Given the extra costs upfront, how do ESG and net zero create value that cannot be otherwise replicated? How do tenants and property managers balance the long-term benefits with the costs?

There are a number of ways to achieve ESG and net-zero goals. The passive approach is just wait until the grid is green. That's not how we operate, and investors generally aren't thinking like that. However, going off the grid and inputting renewable energy is a real challenge, because many urban buildings don't have the space to install solar panels. We therefore have to procure offsite renewable energy, such as solar panels in lower-income neighborhoods. But the cheapest form of energy generation is always energy efficiency – no matter what happens with the grid, saving that energy will always have value.

As a general rule, any improvement is better than no improvement, even if it's the cheaper option. But we have to understand where the tenant or owner is in their ESG and net-zero journey. What's important for occupiers and owners alike is to understand the big decisions you're making, what track you are on, and whether that will necessitate further costs in the longer term. The cheaper alternatives may make you compliant now, but the more expensive option will make you compliant for longer.

"Every year, we find yet another group of tenants that are curious about ESG"

"The biggest question we get today is around energy-saving measures"

Sometimes, the value of net zero and ESG is hard to communicate because the market is not pricing these assets correctly – it's not adding the appropriate premium to green buildings yet for the most part. Fortunately, the pathways to exit from these buildings are becoming more sophisticated.

Q What is the biggest hindrance to achieving net zero and ESG goals in real estate investing?

There are a number of challenges and they start with the fact that this expertise is new and not widespread. There is a need for dedicated expertise, but it's hard to come by; there simply aren't enough people with the expertise that real estate investors and managers need. This translates to ESG and net-zero measures not being reflected accurately in property values. The latest research is suggesting that there is a premium, which has been seen to be above 10 percent in cases, but we still need more data.

There is no universal standard for carbon data yet. Most decisions are based on very little real data, and the rest is based on proxy data. We also cannot forget that some investors and tenants have been disappointed by firms that have exaggerated their ESG achievements. They will show flashy pictures of properties with lots of trees, but these have very little substance. I sit on the ESG committee of INREV and our biggest drive this year is to supercharge data collection to level the playing field and improve transparency. ■

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