The Weekly Take

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Earth Angel: The Rise of ESG in Commercial Real Estate

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Spencer Levy
I'm Spencer Levy, and this is The Weekly Take. In January, CBRE Research published a report that has been getting a lot of traffic, ESG and Real Estate: The Top 10 Things Investors Need to Know. Our most recent investor intentions research has shown that a large majority 60 percent of those surveyed have adopted ESG criteria in their decision making. It's clear that ESG, environmental, social and governance factors are driving key decisions and new strategies across our industry. Now we're going to talk about it, too. On this episode, for the occasion of Earth Week and Earth Day on April 22nd, we focus on the "E"– the environment. In a departure from our typical format, we pull together insights we've gathered over recent months on this important topic, as well as hear some new thoughts from CBRE leaders, including Chief Responsibility Officer Tim Dismond.

Tim Dismond
Hey, thanks, Spencer. Good to be here.

Spencer Levy
And Global Chief Economist Richard Barkham.

Richard Barkham
Thanks. Thanks. Nice to chat with you again.

Spencer Levy
They'll bring us up to date on CBRE's work and perspective on the environmental side – sustainability, green building, call it what you will. And we'll also share notable ESG-related observations and analysis from other guests. Ever since the ESG show we did around this time last year, the topic has come up almost every week in every conversation we have. But because of time, not everything makes the air. So in excerpts and exclusive outtakes, those other voices will highlight important material that hit the cutting room floor. Coming up, we take stock of our work and the industry at large with an eye on the environment. The "E" in ESG. That's right now on the weekly day.

Spencer Levy
Welcome to The Weekly Take. Let's begin our exploration and examination of commercial real estate and environmental impact – to use a lot of "E" words there – by, well, looking in the mirror.

Javier Chico
ESG is something that's changed in the mindset of new generations like millennials and the next generations. They come with that built in. The older generations like you and me,

we have to be persuaded. We have to be convinced. More than ever, we are talking about that. I mean, it's unstoppable.

Spencer Levy
That was an observation by CBRE's Javier Chico, Director of Strategic Pitching for CBRE Spain and Continental Europe, who I spoke with on the show last fall. I visited Madrid on my first European business trip since before the pandemic, and the meetings I had with Javier and others overseas were a testament to two things: 1) Europe has led on the ESG and environmental conversation and 2) this movement seems to be, quoting Javier, “unstoppable.” So let's put it into context now with Tim Dismond, CBRE’s Chief Responsibility Officer, with some self-reflection. Tim, tell us what CBRE is doing as a company when it comes to sustainability.

Tim Dismond
Well, Spencer, we're doing many things, but let me start off by highlighting just three of them. First, we're reducing the carbon footprint of our own operations. And simply put, that means we need to use less energy. So we're focused on powering our operations with 100 percent renewable energy and transitioning our fleet to electric vehicles. Second, we're helping our clients reduce their greenhouse gas emissions through energy efficiency and decarbonization. That includes everything from retrofits and smart building installations to solar power agreements. In fact, in 2021 alone, we implemented more than 3200 projects, and the corresponding CO2 reduction impact was over two hundred and seventy thousand metric tons. That's the equivalent of, let's say, electricity to power 49000 homes or about 300 million pounds of coal burned. And I tell you what, Spencer, we're expecting to do a lot more of that in the coming years to help our clients meet their CO2 reduction targets. The third thing we're bringing strategic partnerships to the forefront of commercial real estate. One example of this is Altus Power. We've partnered with them to identify locations where solar energy and battery storage can be deployed on CBRE’s own buildings’ energy demands. And I'm also excited about our partnership with Turner & Townsend. We're marrying their net zero program management with our global coverage and expertise. In terms of accountability, Spencer, ultimately, we've got multiple stakeholders. It's our employees, our clients, our suppliers, investors and of course, the communities where we work and live. And we are making measurable progress. We have outcome based metrics, training and resources in place, and we are driving accountability through reporting and performance.

Spencer Levy
Tim mentioned Altus Power, a startup that's working to outfit commercial rooftops with solar panels for business to source power in proximity to where it's actually used. We had Lars Norell, the founder and CEO of Altus, on our air back in the fall. So let's rewind to hear his perspective on what he says this type of clean energy is also generating for building operators. And then we'll hear more from Tim.

Lars Norell
A large portion of our customer base have previously attempted to do well with LEED certification and having that stamp of approval on their commercial real estate. We've found that most clients tend to look at solar as the more direct and actionable step towards reducing carbon emissions of a particular building. They kind of tend to leave LEED behind a little bit and focus instead on the carbon emissions that come from their building and what the, you know, building site and solar system can do to not only reduce that, but to create these savings that we mentioned as well. So to some extent, we think LEED, while

very important – solar is standing on its own legs relative to the exact process of the certification.

Spencer Levy
Tim, so often when we talk about green, we talk in theory, but we don't talk about getting down to the hard numbers for measurability, accountability. And so we grow that number again on the measurability about just how much carbon we have reduced our own footprint recently.

Tim Dismond
Yeah, so the numbers I quoted were projects that we executed on behalf of our clients. And that's three thousand two hundred projects. And the corresponding CO2 reduction impact was over two hundred and seventy thousand metric tons. And again, that's the equivalent of powering almost fifty thousand homes, or the equivalent of 300 million pounds of coal burned. So that's a big deal.

Spencer Levy
Let's now turn to Richard Barkham to broaden the discussion. Another CBRE effort, one led by Richard and the research team, was a report that speaks directly to what we just heard about and the business implications of going green. But the trend is not as clear cut as you might think. Richard, we want you to talk about your new Green Report, which talks about how green buildings can push higher rents, the non green buildings. Why don't you tell us about that report?

Richard Barkham
Yes, so we've looked at the green premium. We've collected a unique data set and looked at the precise impact of LEED certification on rents. And as far as we can see, if you have a LEED Gold certification relative to other buildings of equal quality, that equates to a rental premium of between three and five percent. So this is not out of line with other studies. Many other studies have found the same thing, but the latest data confirms it. But there are some caveats to that, Spence. We saw a surge in LEED certification, particularly around 2009-2010, as we were coming out of the last recession, where I think LEED certification was used to differentiate real estate and to gain tenants. I would say that we've seen the rate at which new buildings are being certificated going down quite a lot. So there is a green premium, but it seems that it's not quite as attractive to building owners as it used to be. And there could be a number of things going on here. One is that attention is shifting to other forms of sustainability. Other measures of sustainability particularly focused on carbon emissions. And it could be that other forms of certification are coming into the marketplace – for instance, wellness certification. So there is a green premium, but the level of certification seems to be easing. There's one other caveat that I would add to all of this, Spencer. There is a big spatial difference in the level of certification, and this is quite shocking to me. It's something like 70 to 80 percent of downtown office buildings are LEED certified. It's closer to 20 or 30 percent in the suburbs. So there are still a very large portion of US commercial real estate, particularly in the suburbs, which is not certified and therefore isn't, you might argue, contributing to our journey towards carbon reduction.

Spencer Levy
So let me push this a little bit here, Richard. We had done reports years ago called the Green Building Adoption Index, and that really said that to your point, most downtown buildings, most new downtown buildings are LEED or Energy Star, but that's office buildings. Does your report simply look at the office sector or does it go beyond that?

Richard Barkham
Our report just specifically looks at the office sector. We have done other research into the other sectors. And again, the level of LEED certification is highest in office. It's much less strong in industrial. It's coming into multifamily. But again, LEED certification has really been an office led initiative. So in terms of creating incentives to take the building stock closer to reduce carbon emissions, I think we need new initiatives.

Spencer Levy
One of the new – or at least new-er – initiatives is a certification called Fitwel, which is more wellness based than environmental. But the leader of the group that oversees Fitwel, Joanna Frank of the Center for Active Design, gave us some insights into questions the industry is working to answer. Last year, her firm work with QuadReal Property Group to publish a report with guidelines for optimizing health and safety in industrial spaces. And Jamie Gray Donald QuadReal's Senior Vice President of Sustainability, Environment, Health and Safety, joined her on the show.

Jamie Gray Donald
The table stakes is data around health and well-being. What amenities do you have at your buildings? And then using that data to see how does that compare to the marketplace? How does that line up with other financial indicators you have? What intelligence can you find here? And then as the market moves or as leasing says, Hey, this is important in this market, how quickly can you get certified? So, you know, we're not yet seen in most markets that residential tenants are asking for Fitwel, but we benchmarked the whole portfolio. We know where we sit. We know what we want to improve on. We know what buildings are lacking a bit in amenities, and we're in the midst of correlating that to tenant, the willingness to recommend assets. And so I think it's the being ready. Having the data is fundamental. And then engaging with your leasing teams, so you're making informed decisions about certification and future investment.

Spencer Levy
Richard, what do you think? Wellness is not the same as green, but they're all interrelated. You're not necessarily going to get higher rent. What you are going to get is better tenant velocity. And that clearly will increase the value of the building, even if it doesn't show up in face rent. So I think what we're saying here is you want to have a differentiated product from other product in the market. One of them is green, one of them as well. And whether it's a three or five percent rent premium or it's greater tenant velocity, you can quantify that in the form of greater capital market value. Is that a good way to sum it up, Richard?

Richard Barkham
Yeah. I mean, I think we'd always said the buildings that are either through certification or offering a better wellness experience are going to have fewer voids and lower vacancy rates and higher and more consistent net operating incomes. And that's got to find its way into a little bit of cap rate movement, a little bit of a cap rate premium as well. So yes, I mean, I thoroughly agree with that. Sometimes the market can recognize that easily through certification. Sometimes the market will have to look a bit more closely at actually, how the building is constructed and how it's actually managed. I think a lot of it comes down to the actual performance in management, and those buildings are likely to deliver a little bit more stability in operating income. In the current world that kind of stability in operating income, absolutely at a premium.

Spencer Levy

I bring up wellness because there can in fact be a conflict among even the best intentioned initiatives within ESG. This came up in our conversation with Harvard professors Joe Allen and Jon Macomber, the authors of a book called Healthy Buildings: How Indoor Spaces Drive Performance and Productivity. Time for another rewind, and then we'll hear again from Tim and Richard.

Spencer Levy
Well, Jon, one of the interesting things you said early on in your comments was about this tension between green and healthy buildings. And I know in your book you try to make the case. They were symbiotic. They work together. But let's call it what it is. If you have operable windows, many people in the green world will say that's a bad thing because it lets the energy out. So in general terms, how does green work together with healthy buildings or where are they in conflict?

Jon Macomber
I'll answer this one way, and Joe might answer it a different way. But if you think about a time series of dozens of years, we didn't have healthy buildings issues until the 40s or 50s because the buildings were so leaky. You just build a leaky building and you blow energy out to get the humidity. We didn't have the mold and all that stuff because the building was blowing up there all year long. So then we get into the healthy building era and in, I think in both my Joe and my view, overcompensated. So now you have a lot of buildings that were built really without thinking about ventilation and filtration. So the quick way to address that is open this stupid windows and run the fans, even if it does take some more energy. And it is really quite clear about the benefits – particularly during COVID time – of open the windows have those indoor HEPA filters, they work and that kind of thing. And part of the premise in the book is, yeah, it's not as green as it might have been, but we've gone too far in chasing energy and the actual humans are not doing well.

Spencer Levy
Tim Dismond, your thoughts?

Tim Dismond
We hear the word sustainability a lot, and so often people just think of environmental sustainability first. So the deal with my role is it's about bringing all of the elements of ESG together: the environment, the social and the governance. So as Chief Responsibility Officer, I wear a few hat oversee the reduction in reporting of our operational greenhouse gas emissions. I'm also focused on fostering an inclusive and equitable workplace through our diversity, equity and inclusion initiatives, and also ensuring that our employees are safe and well at the end of their working day so they go home safely. My job just isn't about making advancements in each of these areas. It's about working at the intersection of all of them and identifying how one area can strengthen and uplift another. As you know, Spencer, our Northstar is about creating real estate solutions of tomorrow so businesses and people can thrive. And that only can happen when we create a sustainable future that includes everyone.

Spencer Levy
I like the way you frame that, Tim, because the way you packaged it together is, it's not wellness. It's all a seamless web. And you look at them together rather than separately, and you'll have better outcomes. Would you agree with that 100 percent? Well, turning back to you, Richard, you mentioned earlier on that these standards are changing for many builders today are moving to things like the UN Principles on Responsible Investing

or the Paris Climate Accord, and much of this is being led by Europe. So I presume those were not taken into consideration in this study. But might you address them in the future?

Richard Barkham
Yes. I mean, if you're going to do any sort of statistical analysis, which is what we pride ourselves on doing effectively, you need data and as you say, the ball is moving and it's moving pretty quickly. So we will look at this. And if the last 10 years of LEED certification is anything to go by, then I think, you know, these new measures are going to result in, you know – people call it a green premium, but it might also be a brand discount. That's equally likely. Our European colleagues are moving very quickly to really think hard about, looking at what is the carbon budget that needs to get us to net zero by 2050 and then oiling that down by sector and bolting that down by buildings? Buildings in Europe, you know, have a carbon budget, and if they can't retrofit or create a situation where they can provide a decent workplace and also meet their carbon budget, then ask our colleagues in Europe are talking about what they call Stranded Assets Syndrome. This has really engaged the investor community and they're taking it very seriously. So I expect the difference between carbon efficient and non-carbon efficient buildings. If you want to put it in those terms, it to be two to three through substantially in rents and values over the coming years. So, yes, ball moving very quickly.

Spencer Levy
I've never heard that term before: Stranded Assets Syndrome. But what I think it means is certain clients have quote-unquote red-lined certain assets because they're so non-compliant with green or they can't make them compliant if they put enough money into them, it's not worth the investment. Is that essentially what you're saying, Richard?

Richard Barkham
Yes. I mean, I think we have to be careful. I mean, we're talking about institutional investors with a lot of public profile and fiduciary responsibilities. And there may well be other investors out there that are maybe a little bit less concerned about their fiduciary responsibilities might find these buildings attractive to invest in. But I think there is a lot of public attention on this, as you say, particularly in Europe. And it just may be that there are certain buildings that move beyond the investable universe because of their lack of ability to meet their carbon budgets. I would say at the moment, these are the most advanced European institutions. I think there's no evidence that these types of building are unable to get bank financing. But you could see a situation in five years time where finance is not available for buildings that are unable to meet their carbon budgets.

Spencer Levy
Tim, you and I have been around this business for a long time. Tell us a little bit about how the industry is doing, how it's changed when it comes to sustainability goals and objectives today, and maybe looking at on a historic basis.

Tim Dismond
Yeah, you're right in that it has changed. Sustainability is still considered, right, the name of the game, and our company can play a role in this. Our clients are looking for us to bring the solutions. And right now, I think innovation and technology are two very important components within our playbook to create a more sustainable future. So here's the deal, Spencer, our seven billion square feet of managed buildings gives us unique insights into trends and market gaps. So we're researching, investing and employing the latest technologies, including proven ones like solar, geothermal energy, LED lighting, smart

meters and microgrids, as well as the newer ones too, like low carbon cement, direct air capture and green steel.

Spencer Levy
Green steel – hadn't heard that term before. What's a quick definition of that?

Tim Dismond
Green steel is simply steel, with the lowest carbon footprint currently possible.

Spencer Levy
Green Steel, indeed. That brings up the idea of what our buildings are made of. And one thing I learned talking about ESG this past year is the degree to which the raw materials and the systems that make up a building can have an impact on the people and the work that's done inside. Let's rewind to one of my favorite episodes from the past year with Laura Hines Pierce, who is now the co-CEO at Hines, a development firm that's been using an old school material in sustainable construction: wood, also called cross-laminated timber.

Laura Hines Pierce
I think we're at a really unique moment with ESG. We're finally, I think a lot of factors and stakeholders are converging to really push things forward in an accelerated way where we are pulling together public stakeholders. So cities and countries and broader organizations are starting to put in place goals and restrictions and sort of push from the public standpoint. In addition, as we already talked about, our tenants are asking for more of a focus, really trying to be part of understanding what their spaces are doing from an ESG standpoint. And then lastly, our investors are really starting to push for it and ask as well about what are we doing, and how can they be part of investing in an ESG focused strategy?

Spencer Levy
So what is the market saying? We've taken detailed snapshots of the market speaking with global investors, and frankly, they're pretty close to unanimous in their intentions to focus on ESG and sustainability. But there are other terms that are important considerations for investors – cap-ex and ROI, for example. Here's what one investor, Michael Levy of Crowe Holdings in Dallas, a major investor in one of the hottest markets in the nation, had to say.

Michael Levy
Well, sustainability, it has its importance to the local regulatory fabric around properties that you're building or operating. It has importance to the tenancy and it has importance to the investor base. But there is no single investor base. And so fundamentally there are certain investors in certain parts of the world and in certain investment funds, vehicles that place more or less a priority on these matters. I think what's important is that as a business, you meet the customer where they sit now. With this case, we have customers who are users and we have customers who are investors and we work through the fabric of what makes sense in light of a given property or a given marketplace. I don't think there are any truisms notwithstanding. There are consultants and other publications who are driving a singular point of view, and I think it's a much more varied point of view, depending on who you talk to.

Spencer Levy
Let's turn back to you, Richard Barkham. Are you actually seeing buildings worth more because of these – being certified as some form of green?

Richard Barkham
I think it's both. It's very definitely both. You know, you've got a green premium because of both investor preferences and investors wanting to make sure that they have a public profile that is in accord with society's aspirations to move to net zero carbon. Large occupiers to particularly brand conscious in this respect. And it may well be that we don't want to conflate effect, but there might be a sense in which green buildings are also buildings that are capable of delivering a better experience to employees as well. But one thing that I've noted as well, you know the situation, for instance, in New York and Washington, where state governments and city governments are actually turning towards fines for buildings that are non-carbon-compliant or non-energy-compliant, I should say it's always in terms of energy. And we're seeing something like, I think, 50 cities around the United States thinking or moving towards imposing fines on buildings that are not energy efficient. And increasingly, investors will have to include those funds in their underwriting. That, I think, is where you might begin to see some brown discounts emerging that are not so positive. If you want to put it in those terms.

Spencer Levy
Well, the regulatory risk is something that I talk about quite a bit in the context of multifamily and rent control. But I think the regulatory risk of local markets imposing some form of green compliance in the form of fines or other things squarely on the table and unfortunately, even a building that was built in the last 10 years and tried to be at the modern standards at that time. They may not be protected by whatever the new standards are. Is isn't that true, Richard?

Richard Barkham
I think that's right. Spence, absolutely. As the concerns over climate become acute, particularly in Europe, and people really think hard what it is – it's people really thinking hard about what we need to do to get to net zero or to a minimal climate change by 2050. You know, really starting to quantify that in terms of, you know, carbon budget and then boiling that down to the building level. And I just don't think, you know, people who've been active even recently in constructing buildings have thought in those terms. And you know, as we've discussed, this is most acute and most front of mind in Europe. But it gives you a sense of what might come in the United States as well.

Spencer Levy
Tim, we had a guest named Parag Khanna, who gave some pretty, I would say, somewhat negative views on the future of the environment. And my response to him was, look, we're getting on top of this right now, and if we do what we say, we're going to do and if our clients do what we say that they say they're going to do. We got a shot of turning the corner here, so I'm actually quite optimistic today, more optimistic than I've ever been. Certainly on sustainability at any point in my career. How do you feel, Tim?

Tim Dismond
Yeah, I share that sentiment wholeheartedly. I think we've got the plan. We've committed to it or aligned. Our employees are engaged. They're rallying around what we're trying to accomplish. So I'm bullish, just as you are.

Spencer Levy
Richard, any final thoughts you'd like to tell our listeners about the study and where we're going?

Richard Barkham
No, I think you summarized it nicely. Spencer, I think these changes that are required are expensive. So to the extent that you can absolutely demonstrate to construction to developers that they pay off, then that can only be useful. Any analysis of data is backward looking and as we've said, the ball is moving quickly. But if you do get a rental premium then it makes it easier to justify a higher specification on initial building. And that, I think, helps in terms of the journey to net zero.

Spencer Levy
So Tim, final thoughts tell us where we are, where we're going on the “E” in ESG today for the company and for our clients.

Tim Dismond
Let me end with this: 2040 may sound far away, but when it comes to reaching our ESG aspirations and net zero commitment, we are all in. We've got alignment. We know what we need to do. And again, our employees have embraced our environmental initiatives, and that's not just because it's the right thing to do. It's because it's good business, Spencer. And it also is critical to the success of CBRE.

Spencer Levy
Agree with you completely. Getting on top of these issues has never been more important, not just for solving these issues, but for our business and for the future of our industry.

Tim Dismond
Yeah, I agree. Thank you.

Spencer Levy
I want to thank my good friend and colleague Tim Dismond. And Tim is the chief responsibility officer for CBRE. Second time on the show. Great job, Tim. Thanks for coming back.

Tim Dismond
Thanks for having me, Spencer.

Spencer Levy
And our most frequent guest, our friend and colleague Richard Barkham, CBRE's Global Chief Economist, America's Head of Research. Thank you so much for coming today.

Tim Dismond
Thanks so much.

Spencer Levy
And thanks to all of our guests. Of course, we appreciate the thought provoking insights on the environmental side of ESG. For more on this important topic and on our show, please visit our website, CBRE.com/TheWeeklyTake. You can also find links to the research we referenced on the show, including the popular report mentioned at the top CBRE's ESG in Real Estate: The Top 10 Things Investors Need to Know. Thanks again for joining us. Don't forget to share the show, as well as subscribe rate and review us wherever you listen. Here's to celebrating the planet on Earth Day. We look forward to you joining us again next week for an episode on the future of the office and a look at CBRE's soon-to-be-published office Occupier Surveys for Spring 2022. For now, I'm Spencer Levy. Be smart. Be safe. Be well.