



# MEASURING REAL ESTATE SUSTAINABILITY: WHAT INVESTORS REALLY NEED TO KNOW

DECEMBER 2017 | SARA SCHOEN, SUSTAINABILITY DIRECTOR

 CLARION PARTNERS

# How Do North American Investors Measure Real Estate Sustainability? (Individual Buildings)

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## ENERGY STAR for Buildings

- Developed in 1990s by U.S. Environmental Protection Agency to benchmark building energy consumption; scores buildings on 1-100 scale and provides ENERGY STAR label to buildings that score 75 or higher

## LEED (Leadership in Energy and Environmental Design)

- Developed in 1990s by NGO U.S. Green Building Council (formed in 1993 by 60 firms and nonprofits led by AIA) and Natural Resources Defense Council; certifies individual buildings as LEED Certified, Silver, Gold, or Platinum

## New sustainability certifications for individual buildings

- GRESB now awards equal points for LEED certification, IREM Certified Sustainable Property certification (2015), WELL certification (2015), Fitwel certification (2016), and dozens of other certifications from around the world

# How Do North American Investors Measure Real Estate Sustainability? (Companies, Funds, and Portfolios)

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## UN PRI (United Nations-Supported Principles for Responsible Investment)

- Developed in 2005 by UN Secretary-General Kofi Annan and large institutional investors from 12 countries; signatories required to report to PRI annually, including real estate-specific module; PRI grades companies A-E

## GRESB (Global Real Estate Sustainability Benchmark)

- Founded in 2009 by European institutional investors as a global standard for measuring and benchmarking real estate sustainability performance; assesses and ranks funds and companies annually based on a 0-100 score

## SASB (Sustainability Accounting Standards Board)

- Established in 2011 in U.S. to improve the quality, comparability, and effectiveness of sustainability disclosure; focused on U.S. Supreme Court definition of materiality; issued provisional real estate standards in 2016

## Custom ESG surveys

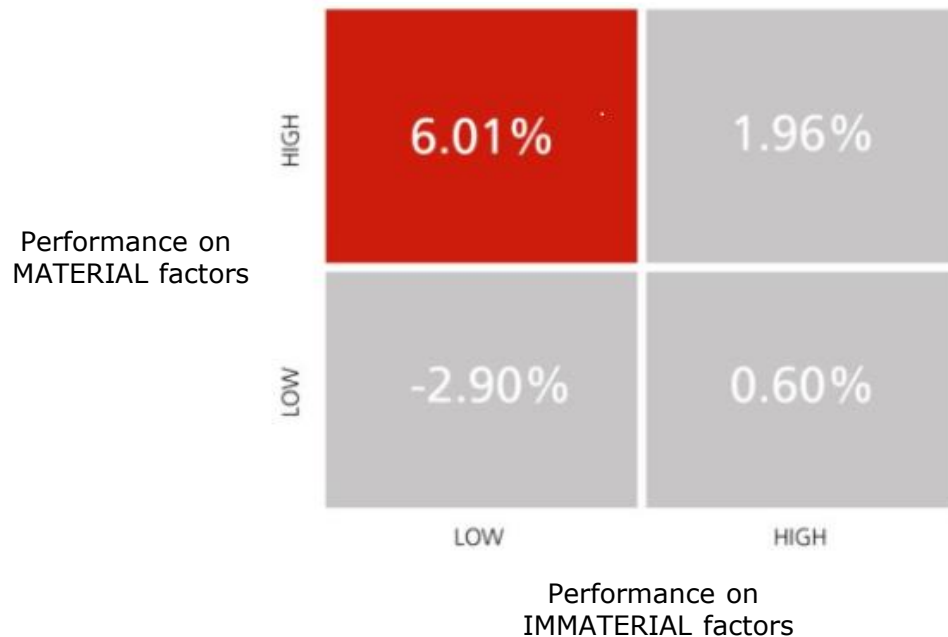
- Cover administrative sustainability activities including policies, programs, procedures, practices, processes, systems, strategies, initiatives, personnel, objectives, green certifications, memberships, reporting, and UN PRI
- Generally do not cover the effectiveness/results of sustainability activities i.e. sustainability performance

# HBS: Relationship Between Sustainability and Financial Performance Mediated by Materiality of Sustainability Issues

“Corporate Sustainability: First Evidence on Materiality”<sup>1</sup> by Mozaffar Khan, George Serafeim, and Aaron Yoon

– Harvard Business School, March 2015; The Accounting Review, Last revised February 2017

Stock Returns (in annualized alpha) by Type of Sustainability Performance<sup>4</sup>



## Findings:

- Firms with good performance on material sustainability issues and concurrently poor performance on immaterial sustainability issues perform the best financially.<sup>2</sup>
- Investments in *immaterial* sustainability issues were associated with average or, in some cases, even inferior performance.<sup>3</sup>
- 80% of sustainability disclosures are immaterial, having no correlation to positive performance.<sup>4</sup>

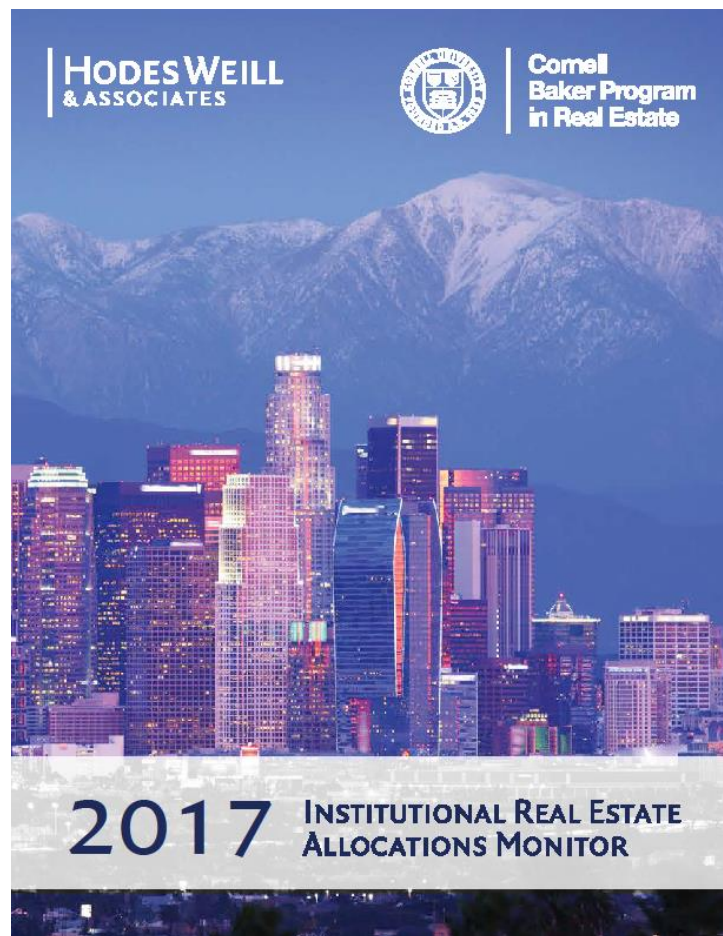
<sup>1</sup> [papers.ssrn.com/sol3/papers.cfm?abstract\\_id=2575912](http://papers.ssrn.com/sol3/papers.cfm?abstract_id=2575912)

<sup>2</sup> [hbswk.hbs.edu/item/corporate-sustainability-first-evidence-on-materiality](http://hbswk.hbs.edu/item/corporate-sustainability-first-evidence-on-materiality)

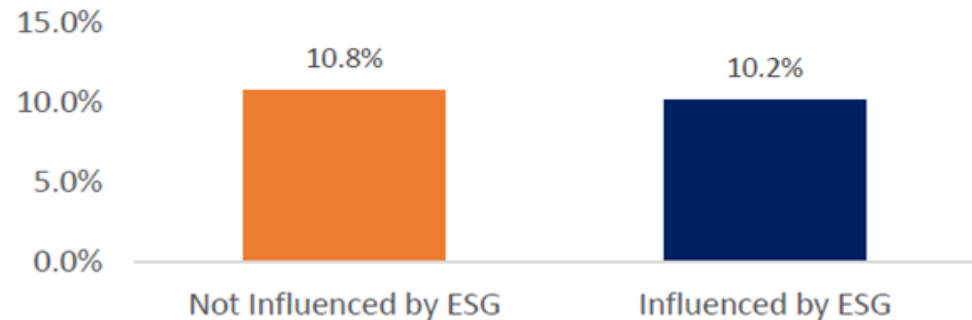
<sup>3</sup> [www.highmeadowsinstitute.org/wp-content/uploads/2014/05/JACF-ESG-Integration-Myths-and-Realities.pdf](http://www.highmeadowsinstitute.org/wp-content/uploads/2014/05/JACF-ESG-Integration-Myths-and-Realities.pdf)

<sup>4</sup> SASB slide deck 8/8/2016

# Do high-sustainability investors and managers focus on the most financially-relevant sustainability activities?



*Exhibit 37: 3-Year Average Returns, By Influence of ESG on Investment Process, All Institutions*



“While it is clear that ESG is a trend that has gained momentum in the industry, **its effect on investment returns is less clear**. Interestingly, **the three-year average returns of survey participants who indicated their investment process are influenced by ESG trailed those that indicated no influence - by approximately 60 bps**. Given that the emphasis on ESG is relatively new for most institutions, it has likely only influenced more recent investments. As a result, it will take many years before the data on returns of these investments is robust enough to begin drawing true conclusions.”

# LEED Is an Excellent Best Practices Guide But Inefficient Measure of Sustainability Performance, Especially on Issues Material to Investors

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LEED is extremely broad and heavy on policy measurement in addition to performance measurement.

- Integrated design process
- Land protection
- Density
- Alternative transportation
- Construction pollution
- Habitat protection and restoration
- Open space
- Rainwater management
- "Urban" heat island
- Light pollution
- Water efficiency
- Stormwater
- Energy efficiency
- Commissioning
- Metering
- Refrigerants
- Demand response
- Renewable energy
- Carbon offsets
- Recycling
- Sustainable purchasing
- Indoor air quality
- Green cleaning
- Integrated pest management
- Occupant comfort
- Light quality and daylight
- Views
- Acoustics

LEED measures individual buildings rather than entire portfolios, making it an inefficient measure of portfolio-wide sustainability (enter GRESB).

[www.usgbc.org/credits](http://www.usgbc.org/credits)

# UN-supported PRI is prestigious and widely adopted but measures administrative activity much more than sustainability performance

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PRI grew from 100 signatories in 2006<sup>1</sup> to 1,870 today<sup>2</sup> representing approximately USD 70 trillion in assets<sup>1</sup>.

Signatories include CalPERS, LACERA, NYCERS, Maryland State Retirement and Pension System, AFL-CIO, UFCW, HOOPP, Ontario Teachers', CEPP, Unilever, and Wespath<sup>2</sup>.

The PRI core<sup>3</sup> and real estate<sup>4</sup> modules cover hundreds of topics focused on policies, practices, processes, strategies, memberships, and other administrative sustainability activities.

- PRI grades are based entirely on self-reported administrative sustainability activity and not on sustainability performance.<sup>5</sup>

PRI unwittingly encourages and rewards paper pushing, box checking, and point chasing rather than sustainability performance improvement.

1 [unpri.org/about](http://unpri.org/about)

2 [unpri.org/directory/](http://unpri.org/directory/)

3 [unpri.org/download\\_report/26907](http://unpri.org/download_report/26907)

4 [unpri.org/download\\_report/25305](http://unpri.org/download_report/25305)

5 [unpri.org/download\\_report/26907](http://unpri.org/download_report/26907)

# GRESB Real Estate Assessment Measures and Rewards Administrative Sustainability Activity Much More Than Sustainability Performance

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GRESB is the primary real estate sustainability activity around which global investors have united.

- 66 institutional and retail investors representing over USD 17 trillion in institutional capital<sup>1</sup>
- GRESB founders: APG, PGGM, USS; Other GRESB members: Norges Bank, AP, Hesta, Cbus<sup>2</sup>
- North American pension funds that use GRESB<sup>2</sup>: CalPERS, UAW, Ontario Teachers', HOOPP
- 850 property companies and funds representing more than USD 3.7 trillion in assets under management<sup>1</sup>

Investors value GRESB because it allows them to compare the sustainability “performance” of multiple funds/managers/companies, but GRESB is an extremely inefficient measure of actual sustainability performance.

- GRESB covers hundreds of topics related to policies and practices. Only 3% of the overall GRESB score and 4% of the *Implementation and Measurement* sub-score is impacted by energy and water performance.<sup>3</sup>
  - GRESB measures and rewards paper pushing and “teaching to the test” more than it measures and rewards true sustainability performance improvement.
- With over 300 sub-questions<sup>3</sup>, GRESB’s core module is orders of magnitude heavier than it needs to be. GRESB’s scoring methodology is extremely complex and somewhat opaque (though increasingly transparent).
  - GRESB would be more effective at measuring sustainability *performance* if it were significantly lighter and simpler.
- There is reason to question the comparability, materiality, and quality of the information GRESB evaluates.

Capturing sustainability “performance” in a single score may be a counterproductive shortcut for investors.

1 [www.gresb.com/about/](http://www.gresb.com/about/)

2 [www.gresb.com/gresb-members/](http://www.gresb.com/gresb-members/)

3 [www.gresb.com/wp-content/uploads/2017/07/2017-GRESB-RE-Reference-Guide.pdf](http://www.gresb.com/wp-content/uploads/2017/07/2017-GRESB-RE-Reference-Guide.pdf)



# SASB Excels in Prioritization and Focus, Includes Some Unnecessary Complexity and Metrics That Are Removed from Performance

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SASB (Sustainability Accounting Standards Board) Investor Advisory Group founding members include CalPERS, CalSTRS, UAW, New York City Retirement Systems, Oregon State Treasury, Ontario Teachers', APG, and PGGM.<sup>1</sup>

SASB released provisional real estate standards in 2016<sup>2</sup>; they have not yet been widely adopted.

Sustainability metrics identified by SASB to be material for real estate investments:

- Energy consumption, floor area ENERGY STAR rated and certified
- Water consumption
- Floor area located in FEMA Special Flood Hazard Areas (climate change adaptation)

SASB prizes simplicity but its real estate standards include an additional section to address tenant energy and water efficiency, adding complexity and metrics that are disconnected from performance:

- Floor area and % of new leases with a cost recovery clause for resource efficiency-related capital improvements
- Percentage of tenants that are separately metered for electricity and water consumption
- Description of approach to measuring, incentivizing, and improving sustainability impacts of tenants

Added complexity and inclusion of administrative criteria reduce SASB's potential effectiveness and efficiency in helping investors measure material sustainability performance.

<sup>1</sup> [www.using.sasb.org/investor-advisory-group](http://www.using.sasb.org/investor-advisory-group)

<sup>2</sup> [www.sasb.org/wp-content/uploads/2016/03/IF0402\\_REOD\\_IT\\_Standard.pdf](http://www.sasb.org/wp-content/uploads/2016/03/IF0402_REOD_IT_Standard.pdf)

# Current Measurement Approaches Don't Efficiently Measure the Sustainability Factors that Most Impact Financial Performance

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Common measurement approaches benchmark administrative sustainability activities more than they benchmark actual sustainability performance.

- By awarding sustainability scores and grades based largely on dozens to hundreds of pages of information that is disconnected from performance, LEED, PRI, and GRESB dilute focus on performance.
- Many sustainability efforts and topics evaluated are likely not financially material.
- Certification and rating schemes often reward box checking, point chasing, and paper pushing.
- LEED, PRI, and GRESB measure and reward administrative activities much more than they measure and reward true sustainability performance. SASB is better but also includes metrics that are removed from performance.

## Alphabet soup and “green fatigue”

- “Reporting on a Vast Array of Dubious Indicators to a Multitude of Non-Governmental Organizations”<sup>1</sup>
  - Real estate sustainability software company Measurabl on the current state of sustainability measurement for real estate managers and companies

<sup>1</sup> [www.measurabl.com/blog/sasb-issues-real-estate-standards/](http://www.measurabl.com/blog/sasb-issues-real-estate-standards/)

# Opportunity: Focus on Performance and Top-Priority (Material) Issues

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Investors can ensure that sustainability efforts are effective and efficient at improving sustainability performance *and* financial performance by focusing their sustainability measurement on *performance* and *material issues*.

- Investors can improve sustainability effectiveness by exercising discipline in:
  - measuring performance only and avoiding measuring administrative sustainability activity.
  - prioritization to focus on a manageable amount of information that can realistically be managed thoroughly to a reasonable level of quality.
- Focus, prioritization, and manageability increase effectiveness.
  - Sharpening focus to performance metrics on the highest-priority issues would improve quality, comparability, manageability, and investor ability to play as active a role as possible in sustainability management.

Real opportunity for investors that are not yet committed to PRI or GRESB and want to focus on material issues and performance to leapfrog to a more streamlined, manageable sustainability measurement approach a la SASB

- Simply measuring and improving sustainability performance is challenging and requires many resources.
- Administratively burdensome sustainability reporting diverts company resources from the most important sustainability issues (measuring and improving performance)
- Better to start with the top priorities and expand scope only when those are well-managed rather than taking on too much at once and reducing ability to execute effectively