ESG Talks: Opportunities & Challenges in Real Estate Investment Management

Edition #1

Series Background
ESG (Environmental, Social and Governance) is arguably one of the most discussed topics in the real estate industry, driven by growing public interest in sustainability and new regulatory requirements. Real Estate Investment Managers (REIMs) in particular are strongly affected by this and face various challenges, since ESG requires a broad change of perspective in many business areas. Therefore, as part of this publication series, Deloitte examines the real importance attached to ESG, the approaches REIMs are taking, where there is room for improvement, and what can be expected from the industry in the future.

The content of this series was collected and analyzed between August and October 2021. In a total of 16 hypothesis-driven interviews, 22 managing directors and department heads of leading European and global REIMs based in Germany were surveyed. Thus, the participants represent approximately €600 billion in real estate assets under management. The aim of the interviews was to obtain a meaningful picture of the industry on the topic of ESG in order to highlight not only challenges and risks, but also potential solutions and opportunities. The interviews were conducted based on seven hypotheses that participants had to ultimately agree or disagree with in the otherwise free-form conversations. Deloitte now publishes a Point of View at regular intervals as a summary of the interview results for each hypothesis.
Discussion of Hypothesis #1

“ESG is a marketing tool. The industry puts its image and regulatory compliance ahead of delivering real impact.”

The hypothesis was discussed controversially. As a result, the classification as a marketing tool divided the participants greatly – there was clear agreement but also clear rejection. Regulation is simply a necessity and, as costly and complex as it is, it is seen as a necessary accelerator. After all, since the introduction of the EU Sustainable Finance Disclosure Regulation (SFDR), new regulatory requirements apply to financial instruments with regard to ESG. Consequently, new product classes emerged in the fund spectrum and thus also an increased pressure for issuers to offer sustainable products according to the regulations (Art. 8 SFDR or Art. 9 SFDR). This pressure comes on the one hand from investors pursuing their own sustainability goals, but also from the companies themselves.

“Public image is important in the real estate industry. However, the public does not always perceive those who are most committed (and put a lot of work into the topic).”

Dr. Nicole Braun, Head of Sustainability, Catella Real Estate AG

Assigning the topic the role of a sole marketing instrument does not do justice from the perspective of current observation. This was also the predominantly unanimous opinion of our discussion partners. On the other hand, the topic cannot be viewed from a purely altruistic perspective, respectively. The external presentation of ESG plays an important role in the marketing instruments of real estate investment managers. Thus, the industry treads a fine line between regulatory compliance on the one hand and the use of ESG as a marketing tool on the other; without falling into the category of greenwashing. In addition to the new regulatory requirements, the increasing demand for sustainable products also contributes to the fact that many of our interviewees feel a high pressure to align their product portfolio with sustainability. This goes hand in hand with the fact that the classification of some fund products in the industry took place at an early stage with media attention, at which time there was still no clear definition throughout the industry or on the part of the regulatory authorities as to what ultimately categorizes a sustainable product.
In this context, it should be mentioned that the sequence of regulatory requirements with the classification of products according to SFDR in the first step and the subsequent definition of the content of the concept of sustainability in the second step poses a particular challenge to market participants and is not without criticism.

In addition to the discussion about regulation, marketing and impact, however, one key point in particular emerged in our conversations: the role of employees and their concern to make the issue of sustainability an integral part of the company’s mission statement. In this way, ESG can be elevated to a core element of corporate culture, independent of product classification and regulatory compliance, and thus make an important contribution to employee motivation as well as in the “war for talent”. Finally, the industry agrees that ESG has arrived in the middle of society and that the challenges lie not only in the transformation of assets and rededication of products, but in particular in the transformation of the companies themselves.

**Conclusions**

Considering ESG solely as a marketing tool does not do justice to the current situation, it is far more than that already. Regulatory challenges and the expected demand for products with sustainability features (Art. 8 SFDR) or impact products (Art. 9 SFDR) are expected to increase in the coming years and pose challenges for REIMs. Investors, regulators, employees as well as the general public will take a close look at what is behind the nice prospectuses. For ESG to be truly embedded throughout the entire company, the value chain must be adapted. This includes the alignment of processes, organizational structures, service provider selection and management, data collection and provision, and in particular corporate culture. Currently, regulatory compliance and external perception often still take priority. However, we do not always observe this due to a prioritization of these factors, but rather due to a yet unclear definition of the term impact and a lack of best practice examples from the real estate industry.

“Strict regulation leads to sustainability being pursued only for compliance reasons without thinking about possible alternatives that might be a better way to reach the goal”

Jörg Kotzenbauer, CEO, ZBI Zentral Boden Immobilien Gruppe
<table>
<thead>
<tr>
<th>Hypothesis #1</th>
<th>Hypothesis #2</th>
<th>Hypothesis #3</th>
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<tbody>
<tr>
<td>“ESG is a marketing tool. The industry puts its image and regulatory compliance ahead of delivering real impact.”</td>
<td>“The sum of individual efforts by REIMs is not enough to achieve the ambitious climate targets of the EU Green Deal. Competitive thinking and a lack of trust confront the industry with obstacles when it comes to collaboration among competitors.”</td>
<td>“REIMs cannot implement a ‘manage to green strategy’ on their own. Collaboration with tenants and service providers is essential for this. However, concrete initiatives are still missing.”</td>
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<td>Hypothesis #4</td>
<td>Hypothesis #5</td>
<td>Hypothesis #6</td>
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<td>“The most sustainable building is the one that is not built.”</td>
<td>“The costs of constructing, refurbishing and operating sustainable buildings will exceed the economic benefits. Sustainable investors will therefore have to forego returns in the future.”</td>
<td>“The integration of ESG along the entire value chain is costly and comes at the expense of profits from management fees. However, the scope for adjustment is moderate. Efficiency pressure on existing business is increasing.”</td>
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<td>Hypothesis #7</td>
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<td>“An ESG scoring/rating is only as good as its underlying data. The incomplete data basis and the need for extrapolation pose major challenges for REIMs.”</td>
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