Sustainable Investment
Practical Guide

This Practical Guide covers key principles of sustainable investment in the built environment

IN A SNAPSHOT

The CFA Institute defines **sustainable investment** in the following way:

'Traditional investing delivers value by translating investor capital into investment opportunities that carry risks commensurate with expected returns. **Sustainable investing** balances traditional investing with environmental, social, and governance-related (ESG) insights to improve long-term outcomes.'

WHY IS IT IMPORTANT?

Buildings and infrastructure are real assets that typically enjoy high capital values and income streams that span several decades. They require significant upfront capital expenditure, and generate returns through both sale and rental values that are attractive to medium and long-term investors. Every stage of the real estate asset lifecycle is dependent on financial flows (capital, debt, equity etc.) which explains why the built environment is a key focus for wide-ranging financial stakeholders from institutional investors, fund managers, real estate investment trust (REITs) and property companies to transaction agents, banks, insurers, and shareholders.

As the practice of sustainable investing has exponentially grown and become more mainstream in recent years, so too has the increased scrutiny and focus on real assets as an investment class. Environmental and social performance of real assets will increasingly underpin their market value so mainstream investors will need to address such aspects as core to risk management and value creation. Indeed, the International Finance Corporation forecast an opportunity to the tune of $25 trillion in the green buildings sector in the coming years, as the world seeks to reduce emissions.

PRINCIPLES OF SUSTAINABLE INVESTMENT

Sustainable investing has traditionally fallen into at least three categories. These are listed below alongside their implications for real assets.

1. Ethical and negative exclusions
These are portfolios that exclude projects or companies on ethical or sustainability grounds – e.g. fossil fuels, mining, tobacco. In the built environment, this has more often been based on tenant activities bringing the landlord into disrepute. More recently it has led to concern that certain assets will become stranded due to their poor environmental performance, low EPCs, or inability to transition to net zero carbon in a financially viable way.

2. ESG investing
These are portfolios that require assets to comply with specific environmental, social and governance (ESG) performance factors as a pre-requisite for investment. Such approaches are typically 'engagement based' – using the investor's financial leverage to improve the performance of the assets they have a stake in. In the built environment, GRESB provides a framework to measure the ESG performance of individual real estate assets and portfolios. Typical ESG criteria for real assets include:

- **Environmental:** Energy efficiency, renewable energy procurement, and carbon intensity are common ESG metrics for buildings. Others include resource efficiency and waste, water use, nature and biodiversity, transport connectivity etc.
- **Social:** Buildings impact our health and wellbeing. Recently there has also been a greater focus on the socio-economic value generated in terms of job creation, quality of life, skills acquisition, community engagement and cohesion, crime reduction etc.
- **Governance:** For real assets this is less well understood or managed but could include the diversity of the management board, executive compensation, community participation, transparency and disclosure, anti-corruption, modern slavery etc.

3. Impact investing
These are investments that explicitly target positive environmental and social outcomes in addition to achieving financial returns. In the built environment, impact investing is typically place-based and driven by the intersection of urban regeneration with financial investment vehicles. Positive outcomes could be buildings that sequester carbon, integrate community facilities, improve air quality, enhance resilience and climate adaptation.

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HOW CAN IT BE DONE?

Each stakeholder across the real estate value chain has a role to play in driving sustainable outcomes through the investment process, with the following being critical examples:

Investors

These are organisations or individuals that buy and own land, buildings, infrastructure projects, urban neighbourhoods etc. They make profits from developing new or refurbishing existing assets, generating rental income, and ultimately selling assets on to other investors. They can be institutional investors (e.g. manage portfolios of assets on behalf of other beneficiaries like pension fund managers) or they can be REITs or property companies whose core business is developing, buying, selling and managing real assets. Either way, as the owners of the assets, they should be held responsible for the performance of them (e.g. sustainable design and construction).

Many investors act as a financial holding company with little in-house activity to construct or manage real assets, so they must ensure that appointed contractors, agents and property managers have the skills and mandate to measure, manage, reduce and report the adverse impacts of their assets and maximise positive impacts.

Agents / advisors

The traditional real estate investment market has depended heavily on transaction and letting agents to broker deals between investors and to find and vet occupiers. These agents have grown exponentially by adding wide-ranging advisory services to their brokerage activities. As well as providing stand-alone sustainability advice and services they should be integrating these into all other service lines such as building surveying, planning, development advice, and property management. As brokers, it should be their responsibility to educate and influence occupiers about the benefits of sustainable assets and to reflect their sustainability requirements back to the investors and developers.

Banks and insurers

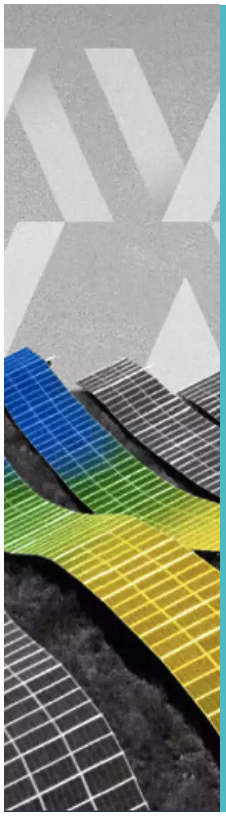
Both investment and retail banks lend capital to investors (individuals and businesses) to buy and redevelop or refurbish real assets. Insurers underwrite their value should major events such as flooding or a fast market transition to net zero carbon assets occur.

Both banks and insurers should be aware of and actively managing their risk exposure to environmental and social outcomes. This requires them to engage and educate their clients and use their financial leverage to accelerate the transition to a more sustainable built environment.

All real asset investment stakeholders should be aware of the material financial risks that the climate and ecological crises will present to built assets and the transparency and disclosure requirements they will be subject to under new reporting regimes such as TCFD and TNFD. Climate change alone presents both transition risks in the journey to net zero carbon assets as well as physical risks from extreme weather events such as flooding, drought, subsidence, and over-heating.

CASE STUDY

Take a look at an example of how Aviva Investors are working on sustainable investment in the built environment.



CASE STUDY: AVIVA INVESTORS

Aviva Investors has provided a **£227 million sustainability-linked refinancing** to property group Romulus (a London based investment and development company), on behalf of Aviva UK Life's annuity business.

The full value of the loan is **subject to sustainability-linked KPIs**, with more favourable borrowing rates available upon Romulus **achieving measurable environmental improvements** in the assets being lent against.

Aviva Investors have a Sustainable Transition Loans Framework, with a **£1 billion origination target**. This refinancing with Romulus has enabled the organisation to reach this target.

Find out more here.

Image source: Aviva Investors

IN SUMMARY...

Investment and finance is critical to the very existence of built assets. Ensuring that it is channelled towards assets that cause no harm to people or planet will become business critical in the coming years. This requires much more rigorous scrutiny of what constitutes a genuinely sustainable asset – e.g. one that complies with science-based net zero carbon performance thresholds of operational energy efficiency and whole life carbon.

READ MORE ABOUT SUSTAINABLE INVESTMENT

RICS: Sustainable Investment in Real Estate
World Economic Forum
Better Buildings Partnership
Global Real Estate Sustainable Benchmark (GRESB)