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KEYNOTE INTERVIEW

Net zero's responsibility and consequences

LaSalle's David DeVos considers how to manage the risk of ESG obsolescence

As the real estate industry moves toward net zero, how to do so cost-effectively is a consideration for investors, developers, vendors, suppliers and tenants. David DeVos, trained and licensed as an architect and now global head of ESG at LaSalle Investment Management, reflects on the direction of travel and how the industry's many constituents must balance competing priorities.

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Q Who has responsibility for net zero?

From my perspective, everybody has an opportunity to play a role in net zero, therefore everyone has some responsibility. Collaboration will be key.

Internally, our portfolio managers need to think about it in terms of their strategy and portfolio composition. Asset managers have a role with asset-level strategy and budgeting, and property managers with coordinating implementation of any interventions that we might make.

Developers play a big role with choosing sites and construction methodologies. And then we need tenants to use best practices.

In order to get everybody on the same page and able to understand the lexicon, we have been aggressively training all of our employees on general sustainability and going deeper on specific topics such as climate risk and carbon. Because we believe our colleagues and supply chain can play a role, we want to make sure we are engaging folks in a way that is meaningful and applicable to their work so they can help us on our journey to net-zero carbon.

One example of collaborating with our supply chain is a project under development in Munich, the TRI office building. It is a hybrid construction: partially existing, partially new construction; partially concrete, partially heavy timber.

Q How are asset owners and investors using data, digitization and proptech?

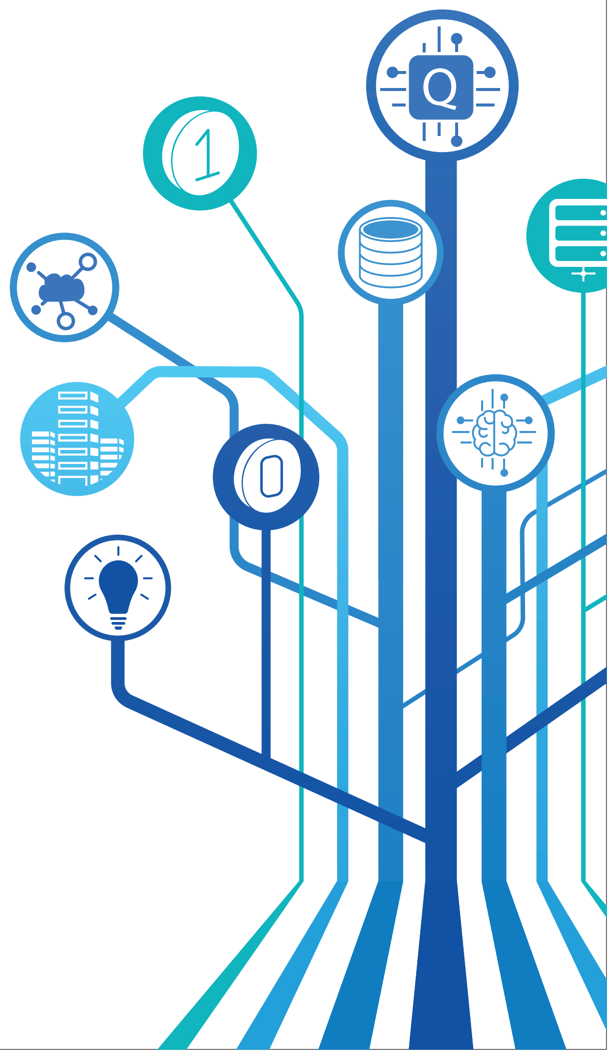
The industry relies on high-quality data. We take a data-driven approach to everything that we do; it is foundational to our strategy. To educate and implement that strategy, we need technology to help collect and aggregate asset-level data.

The industry has been struggling with that for some time. We are trying to automate our data collection to the extent that we can, wherever we can. We are going to need as much data as we can collect to get to net zero.

We recently published a white paper with the Urban Land Institute to help the industry better understand climate risk, interpretation of the data and challenges with data consistency. When it comes to proptech, that industry is on fire and there are new products coming out almost on a daily basis. We do try to pilot those where we can so we can understand what is applicable.

In terms of asset-level technology, not only did the solar industry reduce its production costs and the costs of installation, but as energy prices increase, solar is becoming an even better option for buildings, one that can reduce costs and emissions. As markets evolve, technologies that were on the edge of cost-effectiveness in the past may become more widely used and more mainstream, such as smart building systems and heat pumps.

With reporting and data collection, we try to digitize as much of that information as possible, to help us streamline the process. It doesn't drive the strategy, but it plays a role in comparing performance against our peers and the industry, as well as transparency and disclosure.



New heavy timber, and repurposing as much of the building's existing concrete, can lower the embodied carbon, but additionally we are projecting 65 percent reductions in operational carbon. It is a great example of using some of the old structure with some of the new and of using technology to achieve a building that we think will be highly desirable for tenants in that market.

Q How can asset owners and operators manage ESG obsolescence risk?

In real estate, I consider ESG obsolescence to be buildings that are becoming stranded, where it is going to be very expensive to either mitigate or eliminate climate risk. That can be physical risk such as storms, flooding and wildfires, or transition risk such as tenant preferences, insurance costs and the regulatory environment.

Trying to get our assets ahead of that potential stranding curve is exactly what we in the industry need to be doing. That can affect portfolio construction and as a result we have made considering both climate and carbon a material part of our underwriting methodology and process.

It can also lead to taking a longer view of the asset, looking at not just the traditional hold period but also asking how the buyer's buyer will evaluate the asset. I think it involves a more rigorous assessment before, during and after ownership – an overall life-cycle approach to the property.

The notion of obsolescence being generally bad probably holds true, but for some strategies it may create more opportunities. For instance, there could be a chance for value-add funds to invest and convert properties to highly efficient assets, improving value on the exit.

We are going to see changes in valuations. In some markets, those changes are not priced in, so understanding those markets – where they may be and how to best position a property so that it is not stranded – is important.

And then there is the question of

how owners and managers can manage that risk. It starts with evaluating the properties.

We have performed climate risk assessments on nearly all our global assets and are undertaking net-zero and energy audits across our portfolios globally. We are also monitoring the regulatory environment, both for reporting and disclosure, but also for building performance.

Some markets have fines for poor building performance, where assets are compared to benchmarks, like Energy Star in the US. In other parts of the world, especially in Europe, energy performance certificates also serve as a relative benchmark for assets and can be aggregated to the portfolio level.

We also use the GRESB benchmark to compare our portfolios against other, similar portfolios globally. Another strategy can be to certify buildings; not only is it an indicator to tenants that you have some best practices in place, but there are studies showing that certified buildings are actually getting higher rents.

Stranding and obsolescence discussions are built into our investment process. We are evaluating carbon, climate and the environment, we are asking whether a building should be certified. All of that is part of the investment process before we decide to acquire an asset.

Q What are some other consequences of the quest for net zero?

We want to stay ahead of the low-carbon transition, so as a result we are trying to be aligned or slightly in front of the market, including tenants. That raises questions: are tenants ready to participate? Will they pay for net zero?

We are building expertise and capacity internally, but we are also working with our supply chain to improve their efficiency and knowledge and understanding of what it takes to get to net zero. It is going to take all of us, and all of us need to be prepared.

"There are studies showing that certified buildings are actually getting higher rents"

"The notion of obsolescence being generally bad probably holds true, but for some strategies it may create more opportunities"

For example, embodied carbon – carbon that is found within the building materials and construction processes – was not a discussion in most of the real estate world five years ago, yet today it is becoming more and more common to understand and talk about it. Operational carbon is something everybody understands, and we have been addressing it for years through energy efficiency.

If you are renovating a building, the more of the existing structure you can use, the better. And then different building materials, like heavy timber, would have a lower embodied carbon than concrete.

By reusing the concrete in the building in Munich and adding to it with heavy timber, we can achieve the best of both worlds. Any demolition that takes place, we try to reuse the materials elsewhere in the building. And sourcing new materials locally means it takes less carbon to transport them to the site. All of that combined results in a lower embodied carbon building.

With good decisions, we should be able to dramatically improve the performance of buildings with little or no increase in cost. It is a question of considering the longer-term value opportunities. Real estate investors are starting to look beyond just the hold period and to ask ourselves, "Is this a cost or is it an investment?"

Increasing the efficiency of a building, through retrofitting or low-carbon design, can sometimes add value more quickly than the baseline performance of a portfolio. That is a positive investment and one that we need to accelerate as much as we can across our portfolios.

Are tenants willing to pay? It seems that, for many property types, the answer is yes. And if it isn't now, when will it be in the future? Markets are evolving really quickly. There is a lot of first-mover activity in Europe and pockets of adoption in the Americas and in Asia.

There is also the potential for greenwashing. As an industry, we need to be very careful about how we speak to the work that we are doing, and that we are not exaggerating any claims. We need to ensure we are doing what we say we are doing, and that we are transparent. ■

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