REPORT

THE FUTURE OF REAL ESTATE

ESG, TECHNOLOGY & DATA

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INTRODUCTION

For more than 25 years, GRI Club's exclusive networking events have been providing unique opportunities for the industry's decision makers to exchange valuable insights and experiences, igniting deal flow and potentialising the real estate market.

GRI Club reports provide the key takeaways from these events, including the most valuable insights, the most ardent discussions, and the most intriguing strategies.

This report was compiled following a number of panel discussions during Europe GRI 2023 in Paris. The largest GRI Club event to date gathered more than 700 of the most prominent players in the real estate market, sharing perspectives on the role of sustainability, technology, and data in real estate of the future.

Photos: GRI Club

ENVIRONMENT & SUSTAINABILITY

There is a growing awareness of ESG in the real estate industry, as well as an increasing recognition among stakeholders of the risk of illiquidity for non-ESG-compliant assets. Discussions suggested that there is not necessarily an overwhelming premium for ESG assets, however the threat of illiquidity or obsolescence cannot be ignored.

It is also undeniable that ESG is a factor that attracts, be it tenants or financing, and participants reported that fundraising has proven to be harder when ESG is not involved.

Implementing ESG in real estate assets is more complex. With rising construction and energy costs, a lack of data, varying regulations, and the dynamism of the "green" market, underwriting green CapEx is extremely complex.

Another major challenge involves measuring ESG. There is a lack of accurate and consistent data, and the demand for robust data collection mechanisms is urgent. The environmental realm is more advanced in terms of measuring, thanks to regulations such as the BREEAM standards. In the case of social and governance, however, the industry has a long way to go.

NET ZERO CARBON

Discussion participants noted a recent lapse in focus on zero carbon initiatives. This could be attributed to the scepticism surrounding inflation and rate cycles. Inflationary pressures and uncertain rate trajectories tend to draw attention away from longer-term sustainability goals, steering investors towards more immediate concerns.

Despite this momentary diversion, it was reported that there are numerous opportunities to come within the realm of decarbonisation. The surge of capital flowing into decarbonisation solutions from a multi-assets perspective indicates a profound shift in investment strategies.

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Rather than focusing solely on direct decarbonised assets, investors are recognising the value in backing technology and companies positioned to drive the implementation of sustainable solutions across physical assets. This broader strategy not only diversifies investment portfolios but also acknowledges the potential for scalable impact beyond individual zero carbon assets.

Redevelopment of assets in the pursuit of zero carbon was highlighted as a pain point. This is due to the difficulty of adapting pre-existing assets, and more specifically the lack of knowledge around energy efficiency measures that can be taken during this redevelopment process. Using existing installations in these assets, for example, would be a good step to reduce emissions, however a lack of knowledge around this is apparent.

FINANCING

Participants reported a lack of financing for these redevelopment projects, although there is a compelling narrative for the banking community around zero carbon. There is a willingness from banks to take time to understand the business and the projects, and it is certainly not impossible to engage banks and “seduce” them with the “carbon story”.

Banks are challenged with assessing the credibility of the net zero plan and structuring financing accordingly. This area is uncharted for banks, making it complex to assess. It involves navigating entirely new terrain, translating pathways into practical and achievable goals while distinguishing between what’s realistic and what isn’t.

Banks recognise a distinct difference between standard loans and green loans. Participants predicted that regulations will increasingly incentivise banks towards green financing. One example was highlighted where banks can obtain 25% in their RWA for green loans. Regulation is evolving and unclear, however, thus lenders’ approaches to ESG vary and are yet to be standardised.

There is certainly an eagerness within the banking sector to align with these regulations, particularly in commercial real estate. Banks are actively recalibrating their risk models, acutely aware of the necessity to understand the implications of these regulatory changes.

Specifically, there’s a concentrated effort to assess the impact on transitional rates, especially in scenarios where assets possess lower energy efficiency - a critical factor that may lead to potential stranding scenarios.

Asset managers have the challenge of providing data-based answers to lenders’ questions. The key, as participants reported, is effectively connecting stakeholders so all parties involved thoroughly understand the impacts, the risks, and the evolving dynamics of green assets.

TENANTS

Participants reported that there is no common trend regarding tenant appetite for ESG. They compromise on different levels, and especially between asset classes. In general, tenants still look closely at the rent level.

At times it was suggested that green certifications are simply marketing that either many tenants cannot afford right now, or a cost that cannot be transferred to the end user.

The variation between asset classes is evident, as this idea contrasts significantly with the insights from participants regarding office assets. It was reported that ESG-compliant office buildings are witnessing substantially higher tenant demand, while non-compliant assets are threatened with obsolescence.

TAXONOMY

Discussions saw a consensus on the importance of the implementation of taxonomy within the real estate industry, especially in the context of environmental considerations, serving as a tool to combat greenwashing.

Participants recognised that while the EU taxonomy and SFDR (Sustainable Finance Disclosure Regulation) are being assimilated within the industry, their application allows for asset value preservation rather than an exclusive focus on increasing asset value.

It was highlighted that viewing ESG through a financial lens is imperative, as neglecting it may lead to higher costs in insurance and energy consumption, accentuating its non-negotiable relevance for investors.

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SOCIAL VALUE

The Environmental aspect of ESG has certainly developed further than the Social and Governance aspects. Although social value in real estate has started to gain attention, it remains underdeveloped and current measures are ambiguous and lack definition.

Buildings are for people, and there is a lot of social value to be discovered across all asset classes. Discovery of social value is not assuming that you know the needs of the end user but instead understanding their actual needs and directing the assets towards fulfilling them.

If the needs of people are kept in mind and there is active participation of the tenants in improving the asset, social value discovery is easier.

If tenants are engaged, assets have seen higher involvement, lower vacancy risk, and lower maintenance costs. A fundamental measure of success of an asset is the period that the tenants remain in the asset. Therefore, assets delivering higher social value are inherently likely to be more successful.

CYCLE FOR SOCIAL VALUE
Discussion participants presented the following cycle for social value:

1. Value Identification - Compliance is the first step in identifying value. Making assets compliant does not ensure creation of investible value in assets.

2. Value Creation - Go further and build on compliance terms to create additional value.

3. Value Protection - Ensure created value is protected and sustained over the long term.

4. Value automation - Automate operational aspects to unlock further value.

5. Value Replication and Acceleration - Learn and scale over a larger asset portfolio.

6. Value Multiplication and Extension - Identify additional services and aspects that can create value.

7. Value Monetisation - Gain returns from value created over the chain.

The real estate social value chain is fragmented, however in cases of vertical integration, social value creation is more advanced and all stakeholders can simultaneously prioritise the end user during decision-making.

While there is no standardised way of measuring social value, results can be seen through the length a tenant remains in an asset. Therefore, social washing is less of a risk than greenwashing. Participants agreed that social taxonomy is in sight, and it is expected to offer a “guiding light” for the industry’s move towards recognising social benefits.

It was agreed during discussions that regulation and legislation is already encouraging real estate’s shift towards environmental consciousness, but social value remains more niche, making it a real differentiator of value for those socially conscious assets.

ASSET CLASSES

HOSPITALITY

ESG isn’t well defined within the hospitality asset class, and participants noted that this could raise problems regarding exit strategies for hotel owners in the near future.

From an operational point of view, ESG is extremely important. Following the global economic instability, there are already concerns whether people will continue to spend as freely as they did in 2022. Combined with increasing consumer consciousness around ESG, it is important that guests see visible efforts towards sustainability.

It was suggested that the social aspect of ESG may be considered less complex for hospitality, where hotels are able to have a positive impact on the local community.

ESG regulation is in sight for the hospitality sector however, with CSRD and SFDR reported to be coming soon. The sector needs to find the delicate balance of investing in ESG, and participants reported that this is already being incorporated into some hotels’ CAPEX planning.

OFFICES

In light of the office crisis and soaring office vacancy rates, ESG is playing a pivotal role in the asset class. The demand for offices is polarised and ESG compliant assets are witnessing radically higher demand.

Although location remains the primary criteria for office assets, ESG comes close behind as the second most important criteria. A number of participants advised that every office investment must target top-quality, ESG-compliant products and incorporate digitisation and technology.

LOGISTICS

Insights from discussions revealed a lack of clarity on how ESG and specifically EU directives apply in the logistics sector, as well as lack of clarity regarding the costs for non-compliance. Logistics is far behind other asset classes, particularly offices, regarding compliance standards. However, there is an understanding between stakeholders on the next steps to make assets green.

From both an operational point of view and an exit strategy point of view, ESG is increasingly important. Participants noted, however, that there still exist investors who do not give importance to ESG as a deal making criteria.

Discussions focused on technology within the logistics sector, and the potential was recognised to be substantial. Benefits from reducing the reliance on human labour through automation were also recognised, especially considering recent labour shortages.

However, there was a clear consensus among attendees that the costly implementation of technology and automation can limit the feasibility of assets without a secure future and longer leases. A deeper evaluation is required to determine the viability of automation for this asset class.

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TECHNOLOGY & DATA

In the dynamic world of real estate, technology has become both a beacon of hope and a source of frustration. Technology provides precious insights and transparency into assets and their operations, revealing their intricacies and enabling the development of appropriate strategies.

Innovative strategies, such as using AI to select tenants, are emerging in residential real estate, while monitoring occupancy and other data-driven strategies are being implemented throughout other asset classes.

Real estate is inherently unscalable and demands innovative solutions to achieve scalability. Comparing portfolios remains elusive due to varying asset management strategies, but data can bridge this gap.

Ultimately, it is about understanding buildings through technology to aid decision making, and thus achieve optimisation of space, contributing to reduced energy consumption, intelligent investment, enhanced revenue streams, and more.

Each building is distinct, making plug-and-play technology integration difficult. Combined with real estate's slow pace, the adoption of tech-driven measures is lagging far behind other sectors. Furthermore, seasoned real estate professionals have historically proven resistant to change.

The path to innovation is riddled with costs and discomfort with many companies struggling to undergo digital transformation successfully. Technology is maturing, but the real challenge is fostering a culture that embraces it. Investments must align with intentions, breaking down silos within organisations and starting from the top.

The application of technology, rather than the technology itself, often proves the stumbling block. Innovation in real estate is categorised as incremental, radical, or disruptive. The industry is often slow to adopt disruptive changes, and breakthroughs may come from other sectors.

However, with market dynamics shifting, margins shrinking, and legislation changing, many real estate companies have been forced to venture into the realms of real estate technology. Not to mention the challenges posed by COVID-19 accelerating this process.

Participants highlighted the importance of getting the basics right before chasing the next big innovation. Sorting data, addressing technical debt, and refining the quality of buildings are foundational steps. Data management consumes a significant chunk of time but is essential for informed decision-making. It was emphasised, however, that human intervention remains crucial for quality control.

UPCOMING INVESTMENT TRENDS

Anticipated future investment trends included forests, considering the possibility of generating carbon credits, data centres, and healthcare and senior housing due to demographic shifts.

The array of technologies and software were highlighted as crucial for success, and they must be effectively utilised to manage alternative investments. Furthermore, data is imperative to understanding these new asset classes.

The current outlook noted a relatively low number of transactions in the alternative market. These alternative investments were defined as unconventional approaches to investing but often characterised by higher yields. The strategy of optimising returns by combining different alternative investments was highlighted as a prevalent approach in the current landscape.

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GRI Club

Founded in 1998 in London, GRI Club currently brings together more than 10,000 senior executives spread across 100 countries, operating in both real estate and infrastructure markets.

GRI Club's innovative discussion model allows free participation of all executives, encouraging the exchange of experiences and knowledge, networking and business generation.

GRI Club Members also have access to our exclusive online platform to learn more about other members and their companies, correspond and schedule meetings, and receive unrestricted access to all GRI Club content.

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