



# Insurance AUM Journal

*The Industry's Investment Resource*

Q3 2020



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## INTERVIEW

Grace Vandecruze

*Author of*

**From Homeless to Millionaire**

*Thought Leadership for the Insurance Investment Community*

## Investors Expect and Demand Meaningful Environmental Goals and Progress

**There is no doubt that environmental, social and governance (ESG) principles play an increasingly influential role in investment management today. For real estate investors in particular, climate change has arrived as a material risk both in terms of physical risk from floods, hurricanes, and wildfires, as well as transitional risk such as compliance, insurance, and tax increases. During 2019 the U.S. was impacted by 14 natural disasters that each resulted in at least \$1 billion in damages. Globally, damages are projected to grow to \$54 trillion as early as 2040, if we continue along the current path.**

The real estate industry has focused on ESG factors to combat the risks and impacts of climate change noted above. There is widespread recognition that a meaningful commitment to ESG can protect and increase a property's value by decreasing regulatory compliance risk, functional obsolescence, insurance premium increases, reputational risk, and down cycle valuation risk.

While we believe risk mitigation is a critical goal, environmental factors also play a role in enhancing a property's net operating income (NOI). Simply stated, the best-run buildings from an ESG perspective will likely have higher occupancy rates, and perhaps even higher rental rates. Such buildings also will have lower operating expenses, as they are focused on reducing energy, water consumption and waste. The result should be higher NOI and higher value.

Reflecting both the risks associated with climate change—and the potential rewards in terms of better property performance and value—the real estate industry is increasingly prioritizing ESG in investment strategy. In response, it is important to set ambitious sustainability goals and take bold action for the betterment of properties, their occupants and the collective well-being of society.

### **COMMITMENT TO ACTIONABLE PROGRAMS, REPORTABLE PROGRESS**

Real estate investors are signaling that ESG is becoming a core part of their investment strategy—and that they are seeking to invest with companies that make ESG a priority across their organization. Citing its [recent survey of ESG leaders in real estate](#), Deb Cloutier, President of RE Tech Advisors, confirmed that, “65% of the companies intend to

increase their ESG budgets in 2020, with 27% indicating that the increase would be significant.”

Underscoring the strong shift toward ESG in real estate investment, Billy Grayson, Executive Director of the [Center for Sustainability and Economic Performance](#) at the Urban Land Institute, has noted:

**“Global investors with a combined \$16 trillion in AUM have committed to sustainable investment principles—any real estate company looking for global capital needs a strong ESG strategy to meet this demand.”**

Investors also have begun insisting on evidence of ESG commitment via enhanced standards and reporting. The leading set of ESG standards is defined in the [GRESB Real Estate Assessment](#), which has recently expanded to include health and wellness items, and in 2021 will incorporate resilience and a sharper focus on data quality. During the 2019 GRESB reporting period, more than 1,000 property companies, REITs, funds and developers participated in the reporting on \$4.1 trillion in investment assets. As Dan Winters, GRESB Head of Americas, states:

**“GRESB investor members use the annual benchmark results to set ESG performance targets, monitor portfolio progress and report key metrics to both beneficiaries and the general public. Investors are clearly focused on climate change risks, resilience and adaptation measures, and tracking impact metrics.”**

At MetLife Investment Management (MIM), this data-driven approach is reflected in the efforts of our Risk, Research and Analytics team, which works with our Asset Management team to study the impacts of issues such as ESG and COVID-19, as referenced in a recent [white paper](#), “Back to Work: Office Demand in a Post-Pandemic World”.

Today's smart building management systems and technologies support a higher level of environmental performance, while providing the rigorous reporting that investors seek.<sup>1</sup> We favor the use of energy conservation measure (ECM) surveys for various property types—office, multifamily, retail and industrial—with sector-specific questions about electricity supply contracts, onsite power generation, advanced metering, LED lighting usage, water flow, and HVAC systems and controls, among other factors. We believe such surveys are essential if investors are to have—and act on—meaningful environmental data.

### AGGRESSIVE GOALS RAISE THE BAR

The real estate investment industry has recognized that sound environmental stewardship and overall excellence in real estate asset management must go hand-in-hand. A few years ago, it was sufficient for a property to adhere to common industry certifications, such as ENERGY STAR or LEED in the U.S., or BREEAM internationally. Today, as the real estate market evolves from its earlier focus on energy efficiency, new goals may include carbon neutrality, 100% renewable sources, resiliency in the face of natural disasters and climate change, and protecting the health and wellness of occupants. We also would expect to see a greater emphasis on exchanging knowledge with all the “partners” and stakeholders who are critical to the success of an ESG-oriented investment strategy (including property managers, leasing brokers, contractors, tenants, energy suppliers and other vendors/service providers).

To signal their commitment to sustainability, investors and managers may want to consider joining the United Nations Global Compact (UNGC), the world's largest corporate sustainability initiative. MetLife was the first U.S.-based life insurer to join the UNGC, which calls for companies to align their operations and strategies with [10 universal principles](#) in the areas of human rights, labor, the environment, and anti-corruption.

Our experience at MIM exemplifies the path real estate investors are taking toward sustainability. In 2013, we launched the ESG Challenge to encourage our regional real estate teams to focus on energy, water and waste conservation in their portfolios. We set a goal of reducing energy, water and waste by an average of 2% per year. Two years ago, we made that goal public by signing on to the Department of Energy's Better Buildings Challenge, which requires a commitment to improve the energy efficiency of a portfolio by at least 20% over 10 years. In 2019 and again

in 2020, MetLife, Inc. and MIM were recognized by the EPA as an ENERGY STAR [Partner of the Year](#). This reflected MetLife's certification of more than 12 million square feet of real estate in the ENERGY STAR program, as well as several other initiatives.

We believe it is important to set aggressive goals for environmental progress—as investors, commercial tenants, multifamily residents, and hotel guests deserve no less. For example, MIM's efforts to achieve carbon neutrality across our portfolios are embodied in our MetZero program. While this will initially require the use of carbon offsets and renewable energy credits (RECs), we plan to derive a growing percentage of the carbon reductions via energy efficiency and renewable energy over time.

### TAKING A “GREEN STACK” APPROACH

As investors seek to improve the ESG profile of their holdings, they may benefit from what we call a “green stack” approach. Similar to a “capital stack” comprised of different layers of capital, a “green stack” consists of various tranches of investment needed to upgrade a portfolio from an environmental perspective. For example, below are several “tranches” that represent various stages of carbon neutrality:

#### **Tranche 1: Reducing Energy Demand.**

This may include traditional conservation measures and working with tenants, residents, and property operations staff.

#### **Tranche 2: Onsite Renewables.**

Initiatives might include investing in and installing solar, wind, combined heat and power initiatives like turbines and fuel cells.

#### **Tranche 3: Offsite Renewables.**

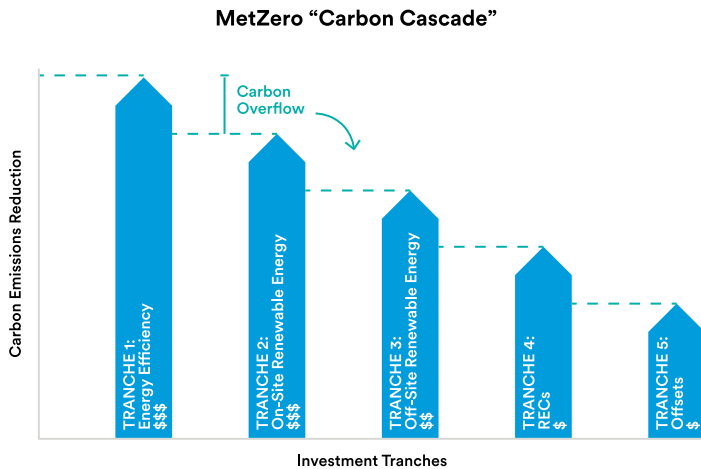
This tranche could involve investing in Virtual Purchase Power Agreements (VPPAs) or helping to fund the development of a new solar or wind farm.

#### **Tranches 4 and 5: RECs and Offsets.**

While Renewable Energy Credits and Carbon Offsets are a relatively substantial contributor to carbon neutrality at present, our model assumes they will reduce over time. By applying a methodical approach to the first three tranches, the investment in RECs and offsets should be substantially reduced due to less energy demand and existing renewable energy initiatives.

<sup>1</sup> Source: MIM Analysis

By taking what we call a Carbon Cascade™ approach to achieve carbon neutrality goals, investors may systematically lower emissions through investments across the series of tranches.<sup>2</sup>



**DASHBOARDS PROVIDE ACTIONABLE INFORMATION**

Making progress against environmental goals requires the use of a range of reporting tools and resources. In this regard, investors should consider using real-time energy dashboards, which can monitor factors such as ENERGY STAR scores, performance metrics and certification status. Such dashboards allow for easier use and visualization, enable an asset management team to see the performance of its properties, and permit users to share best practices. The use of dashboards may also better enable investors to comply with an increasing number of potential legislative initiatives that many U.S. cities are enacting. In many cases, this legislation includes mandatory carbon or energy reduction targets as well as annual reporting requirements.

**ENVIRONMENTAL STRATEGIES IN A POST-COVID-19 REAL ESTATE MARKET**

It is imperative that firms in the business of building, acquiring, and providing active asset management of properties be able to provide space that helps commercial tenants, and their employees and customers, live healthier and more productive lives.


In this regard, COVID-19 has emerged as one of the biggest challenges for commercial real estate. Changes in society, workplaces and consumer behavior will impact the way we live; how we use residential spaces; how we design offices, retail stores, manufacturing and logistics

facilities; and the value we place on health and well-being in the built environment. While we are cautiously optimistic about the long-term outlook, the current challenges and uncertainty should greatly increase the value of proactive asset management and innovative action. Enhancing the well-being of spaces will require working with tenants and residents to achieve the benefits of healthy buildings. As noted in the [pioneering work](#) of Dr. Joseph Allen, of the Harvard T.H. Chan School of Public Health, healthy buildings can drive performance and productivity.

Investors would be well advised to respond to the challenges of COVID-19 by providing guidance and best practices to ensure that commercial buildings are being operated in a safe and efficient manner, with the focus on the health of occupants, guests, staff and vendors. Building owners also should work proactively with tenants and borrowers as they navigate the difficult circumstances that COVID-19 and the economy have presented.

**THE GOALS: IMPROVING OCCUPANTS' WELL-BEING AND THE PROPERTY'S NOI**

In summary, we believe advisors and asset managers must meet the needs of investors by establishing forward-thinking ESG goals—and must work diligently to achieve and exceed those goals. These include environmental goals that mitigate the risks of climate change by reducing energy, water and waste. They also include a focus on health and wellness, building engagement within the asset and the community, and regular disclosure and reporting of results. It is also crucial to focus on resiliency, in terms of mitigating the potential impact from local events, natural disasters and the exacerbating effects of climate change. Finally, it is important to conduct an ESG assessment for all new property acquisitions that includes identification of potential impact from these factors.

Maximizing the value of a real estate investment has traditionally been about driving net operating income. But, increasing NOI cannot be an end in itself. Achieving income growth and capital appreciation requires a sincere commitment to doing the right thing in ESG terms—as a responsible fiduciary and asset manager—for investors, occupants, and the other partners in the real estate investment value chain. 



JIM LANDAU, LEED AP  
Head of Asset Management – Real Estate,  
Washington DC Region

<sup>2</sup> Chart Source: MIM, ReTech Advisers



**Disclosure**

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insuranceaum.com  
journal@insuranceaum.com  
847.868.0044

