

The Investment Podcast

Real estate series

Episode 2: Building a more sustainable future

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Jose [00:00:34] Buenos Dias everybody. My name is Jose Pellicer and I'm the Head of Investment Strategy at M&G Real Estate. Welcome to episode two of the real estate series for The Investment Podcast. In this episode, we are going to talk about sustainability. During most of my career, I have seen sustainability gain traction very slowly in the minds of real estate investors. But the world is changing. I would even say that capitalism is changing, from shareholder value to investment with purpose. Countries are regulating more heavily, and investors are pledging that ESG will be at the centre of what they do. Is this a pipedream? Is this just greenwashing? In order to cast some light into this, we have Nina Reid, who is the Head of Responsible Property Investment at M&G Real Estate. Nina has been at M&G for over 10 years and brings a breadth of experience and enthusiasm to the topic. Nina, welcome to the podcast.

Nina [00:01:46] Hi Jose.

Jose [00:01:48] So, you must be really happy that after a lifelong career in ESG, you are in the spotlight, aren't you?

Nina [00:01:58] It's very exciting times for those of us that have been working in ESG for a long period of time, seeing the awakening of the [real estate] industry to ESG issues and it's increasing importance in terms of investment decision making.

Jose [00:02:18] And it's industry, and it's also governments, right?

Nina [00:02:22] Yeah, industry, government. But also individuals as well, which is I think, one of the key reasons we've seen such an awakening from governments and businesses. It is the reflection of individuals particularly, off the back of the climate marches that we saw a couple of years ago. Individuals are starting to ask questions of companies, of businesses and of governments.

Jose [00:02:52] Yes I totally agree. I think that there's also probably a generational change. So, people who are now 10, 20 years younger than myself are seeing a risk in the world on climate and how that will affect their future. Now, let's move into your own story or your own history, could you describe your journey at M&G or your professional journey in general in the last 10 to 15 years you have been working in the field?

Nina [00:03:31] Yes. So, I started my career in sustainability. I was working as a sustainability consultant advising businesses, and at the start of my career lots of businesses were only at the very beginning of thinking about sustainability and what it meant to them. I joined M&G 10 years ago now, and I think when I joined there was a sustainability approach within the business. M&G, and what was PRUPIM, was one of the very first fund managers to really be thinking about these issues. But I'd say definitely what we've seen over that decade is essentially moving from being a fairly property management, day-to-day energy reduction type programme, to now being in a place where our interactions are with the fund managers are about fund strategy and future-proofing and about the sort of implications that ESG will have on fund and asset performance. So, I think that moving from the sort of nuts and bolts to perhaps being very much front and centre into how we manage our funds and how we think about the buildings and their performance.

Jose [00:04:53] Yeah, exactly. Because in order to achieve results, you really need to be strategic and the guys making the decisions have to be engaged. Otherwise, you know, it just doesn't work, right? So, given the experience of the last year or couple of years, do you think, I really have to ask you this, do you think that the ESG mania is here to stay, or do you think this is just a temporary thing?

Nina [00:05:22] I think it's interesting that during the pandemic when we could perhaps have seen trends falling away, actually, what we've seen is a strengthening if anything. I think there's more focus on ESG even through the period of the pandemic than there was before and I think that probably reflects that it is a trend that is here to stay. I think we're seeing such enormous commitments from financial services organisations such as ourselves, but also corporates like Microsoft making incredibly ambitious kind of carbon reduction targets, that I think the trend is here to stay. I think the interesting thing is that we've had this period of very ambitious commitments and now we're kind of moving into the part where that rhetoric has got to be followed up with action. I think that will be the really challenging part, can we achieve these targets as fast as we need to?

Jose [00:06:31] Yeah, exactly. I think M&G has been very public in announcing, or M&G real estate has been very public in announcing their commitment to go to net zero in 2050. But this is a tall order, right? So, a lot has to be done in order to achieve this, in terms of retrofitting buildings, et cetera?

Nina [00:06:53] Yes, I mean, when we look at the kind of pathways that we expect buildings need to hit to achieve net zero, it will require, you know, mass retrofit of the building stock across the world. And also, as we get closer to 2050, it will require incredibly ambitious reductions in the energy consumption of buildings and ultimately, the built environment, if we are to achieve those targets will need to be incredibly different by 2050.

Jose [00:07:30] Yeah, yeah. That's actually what I was going to ask you. So, the built environment, buildings, will be different, but not just that, the way we use them, the way we go to work. So, 2050 will look very different to today, right?

Nina [00:07:50] Yeah, I think it will look very different in terms of the built environment itself because to achieve the sort of targets that we're setting and also the fact that we will continue to see changes in the way that people interact with buildings and also their expectations of them will continue to change. We could see buildings being built very differently to manage the energy and carbon targets, and also I think the other thing that will have to change invariably and again, we've already seen the sort of starting point of this, is the relationship between ourselves as building owners and the occupiers of those buildings. So, I think one of the things that have become very apparent to us as we're starting to look at some of our market-leading buildings in terms of energy and carbon performance is actually we cannot achieve net zero without the buy-in and support of the occupier. I think it would have been unthinkable five years ago that you would have clauses in your leases that would require occupiers to run a building to maximum energy consumption, but that is probably where we're going. Over the next decade, we will probably start to see that with other things as well, like offices. I expect that we'll start to see more requirements from occupiers about air quality and air movement, particularly off the back of the pandemic but again, off the back of the wellness/well-being trend that we'd already started to see pre-pandemic as well.

Jose [00:09:29] Yeah, actually for the listeners who are not in the real estate industry, they think that this is just a landlord's task, but it's totally true that if you own a multi-let office building with several occupiers and you want to achieve net zero, they have to contribute to that through energy reduction on their own, water recycling on their own. Otherwise, that's not going to be achieved, right?

Nina [00:10:04] No. It's very much going to be a sort of partnership with the occupiers to achieve this. And as a building owner, it's quite exciting to see corporates setting their own net zero commitments because essentially it provides a very clear market for us creating a product that delivers those occupier ambitions. I think the challenge for the market will be that uncomfortable period where the nature of leases and the relationship between landlords and occupiers will need quite a significant evolution, to achieve the outcomes that both parties want.

Jose [00:10:44] Absolutely, and not every occupier has the same ambition, you know, a small company is not the same as a large listed corporate. Now, can I move to something else I wanted to discuss with you? One of the myths, or key narratives, about ESG is the relationship between ESG performance/ environmental performance and investment performance. So, is that a myth? Is there a positive correlation there or is there some reality behind that claim? What's your opinion?

Nina [00:11:33] I think that in general, where there have been studies around green buildings particularly, and the impact that has on the value, what generally those studies find is that valuation is often higher for green buildings than it is for non-green buildings and actually you generally see an increase in rental income and occupancy. One of the challenges, I think, is that we have a very 'un-standard' market in terms of real estate and certification, so not every building has a certification. Actually one of the challenges is people don't necessarily understand the performance of the buildings in terms of greenness and therefore, that's quite difficult to price in and it's quite difficult to draw conclusions about how that's playing out in the market. I think what we will find is that we're about to move into a period where... we're already seeing it from investors, there's a much stronger focus around green building certification and also, we're starting to see the regulation ramp up. So, this sort of depreciation at the lower end where buildings are energy inefficient, we're sort of seeing the effect of that. I expect that we will probably start to see an even more marked effect over the next five years or so.

Jose [00:13:05] The certification business has always been a bit of a mystery to me. The British have their certification, the French have their own, the Americans have their own. So, is that all the same thing or are they comparable? Or, you know, so a LEED building, which is the American certification and a BREEAM building, which is the British, are they the same thing, or is it totally different? Do we need to get some standardisation on this topic?

Nina [00:13:35] I think definitely as a global real estate manager, we would very much like to see a bit more standardisation in the market, and I think our investors would as well. There have been studies to compare the different certifications against each other and broadly, they are similar, BREEAM and LEED and most of the other sort of major certifications. But there are differences between them. I think on that theme as we start to see more people wanting to label buildings as net zero, for example, again, there isn't really a certification that can be used at the moment. Ideally, we would like something that would

be globally applicable and comparable for ourselves so that we can understand our buildings globally and how they're performing. I expect that probably won't happen and you'll probably get sort of regional pockets of certification.

Jose [00:14:40] And people like you will have to strategize from a bottom-up perspective, what the right pathway is.

Nina [00:14:46] Yeah, and I think our approach to date has always been trying to marry up what our investors want and what the occupiers want, and to try and be led predominantly by what certification the occupiers most recognise in those markets. However, as we go forward, it may be that some certifications end up having more investment value than others and we will start to move to those.

Jose [00:15:18] Okay, so, therefore, investment managers or property owners who don't do that type of work, who don't retrofit their assets, are going to suffer very bad performance over the next 15 years. Would that be your view as well?

Nina [00:15:36] I definitely think we're going to start to see greater differentiation in the market between buildings that can easily be retrofitted or already meet the growing net zero or green building certification standards. Well-being as well, I think will be quite important. And for those that either, can't be retrofitted at all or where it's incredibly costly and difficult, I think we will increasingly see valuation differentials in the market of those, and managers or owners that are not well prepared could be caught out with the market changing quite rapidly.

Jose [00:16:19] Okay, so the last thing I want to talk about today actually is social. So, we talk about ESG. In the real estate business, we tend to talk mostly about environmental, but obviously, there are social aspects to real estate. So, has the social emphasis of real estate changed in the last 10 years? And the net zero pathway, does that have in itself a social impact, which could be positive or negative? What do you think about this, Nina?

Nina [00:16:55] I think the trend that we've seen from our investors is that the queries are still weighted towards the environmental, albeit I think we are starting to see a growing awareness for investors about the social impact that their investments can have broadly and then also specifically within real estate. Within our responsible investment approach to real estate, social issues are key component of that. I guess the challenge with the social aspect is you have to tailor your social programmes to the asset class that you're dealing with. So, you know, in shopping centres, we're talking predominantly about, are our assets accessible to everyone within that community? And the running of community programmes that are tailored to the sort of demographic and the market of those assets.

Jose [00:17:54] But, residential is the complicated one, isn't it?

Nina [00:17:57] Yeah. So, then residential our programmes are focussed on creating a sense of community at the asset. So, obviously running events, pre-pandemic. But during the pandemic, you know, we've been doing virtual reach out to occupiers, sending newsletters and we've been training our onsite teams about how to be a mental health first aider. So, the first point of contact. There are huge amounts you can do in the residential space. In offices, again, you've got the community programmes, but also the office occupier is focused around that wellbeing piece that we spoke to earlier. So, I think what it means to think about social value does differ by the asset type and then I think you've got this bigger social value, social impact trend that you're seeing about investment into asset classes that are providing more social good. So, you know, affordable housing, health care and education type assets.

Jose [00:19:01] Yeah, exactly. And I think that those probably merit a conversation of their own. So, Nina, I think this has been a fascinating conversation. So, thanks so much for having been on the podcast and everybody in the audience, thank you very much and have a very good day. Muy Buenos Dias.

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