Private Markets – Allocation Themes

Green Real Estate

GLOBALFUND SEARCH

Green Real Estate at a glance

Green buildings, characterized by their energy efficiency, environmental performance, and occupant well-being, represent not only a sustainable investment opportunity but also a paradigm shift towards environmentally conscious and socially responsible real estate practices. As the real estate industry grapples with the challenges of climate change, investors are increasingly turning to sustainable practices to not only mitigate risks but also generate alpha, thereby harnessing the financial potential of green buildings to navigate the complexities of climate change and contribute to a more resilient, equitable, and sustainable built environment.

Why invest in Green Real Estate

- Financial Returns: Green buildings often yield higher financial returns than traditional properties. They tend to have lower operating costs due to energy and water efficiency measures, leading to increased net operating income and potentially higher rental rates or property values.
- Risk Mitigation: Green buildings are more resilient to climate-related risks such as extreme weather events, flooding, and rising energy costs. By incorporating sustainable design and construction practices, investors can mitigate risks associated with physical damage and regulatory changes.
- Environmental Impact: Investing in green real estate contributes to reducing carbon emissions, conserving natural resources, and mitigating environmental degradation. By supporting sustainable development practices, investors can significantly address climate change and promote environmental stewardship.

What are the main risks of green real estate

- Regulatory and Policy Risks: Changes in environmental regulations, building codes, and government incentives can impact green building projects' financial feasibility and operational requirements.
- Technology and Innovation Risks: Green building technologies and sustainable practices are continually evolving, posing risks related to technological obsolescence, performance uncertainties, and implementation challenges.
- Construction and Development Risks: Green building projects often entail higher upfront costs, longer construction timelines, and complexities associated with sustainable design and materials.
- Financial Risks: While green buildings can yield long-term cost savings and enhanced asset value, there are financial risks associated with higher upfront investments, financing constraints, and potential market fluctuations.

What characterizes Green Real Estate

- Investment Strategy: Green real estate investment strategies encompass a range of approaches, including core, core+, value-add and opportunistic, with a focus on long-term sustainability. Investors integrate ESG factors to manage risks, promote innovation, and generate financial returns aligned with environmental and social objectives. Overall, value-add and opportunistic real estate strategies might provide more flexibility, and market opportunities necessary to implement green initiatives effectively, driving value creation and sustainability outcomes for investors and stakeholders alike.
- Industry/Sector: In various real estate sectors such as commercial, residential, and industrial, green buildings are characterized by their commitment to sustainability, featuring energy-efficient systems, eco-friendly materials, and amenities that enhance occupant well-being while minimizing environmental impact.
- Integration of ESG: From value creation and risk mitigation to impact measurement and reporting, the focus on ESG plays a critical part although the approach may vary.
- Instruments: Equity (debt impact to be covered in separate theme).
- Target Asset Size: Small / Mid / Large.
- Geography: Global, regional or country-specific. Subject to the geography, the sustainability evolution might differ and hence the meaningful focus area will be customized.

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Manager Q&A

"What is driving the evolution of the opportunity set in Green Real Estate?"

Fidelity

The impact of the climate crisis on investment portfolios is increasingly evident. And perhaps more than other asset classes, real estate is at the crossroads between physical and transition risks.

Climate risk unfolds over the long term, so many investors may not see it as a priority when they face more pressing threats. However, in an environment in which the climate crisis increasingly intersects other aspects of the global economic and geopolitical spheres, we believe investors should pay attention.

NREP

Humans spend 90% of their time in buildings and real estate is the world's greatest asset class, meanwhile real estate is also causing a third of the world's green house gas emissions. Aside from being responsible business, the opportunity of green real estate is driven by a long-term view, innovative thinking, and risk-mindedness, and should be taking both physical climate risk and transition risks into consideration. We also see drivers in tenant demand, and new regulatory demands. Regulation from the EU, governments, cities and municipalities proves the demand for decarbonization and transparency. We welcome regulatory frameworks and requirements that drive impact, and intend to stay ahead of the regulatory requirements and will continue to work actively with NGO's and academia to align our approach and efforts with climate science. Understanding the regulatory changes is key to maintain our license to operate and mitigate climate related risks.

Invesco

Real estate physically and metaphorically houses the economy. As a real asset, contributing to over a third of GHG emissions globally, there are countless measurable and tangible opportunities to be explored with green real estate for nearly all relevant stakeholders, from occupiers to governments implementing regulatory changes. The occupier demand curve has increased exponentially in recent years with corporates setting environmental targets and seeking more sustainable, green, healthy buildings to occupy. Residential tenants also have a heightened awareness of rising utility costs and increased needs for spaces that provide more sustainability features and comfort for wellbeing. Governments across the globe have been developing, and continue to develop requirements that not only provide greater levels of transparency, but set expectations to how buildings should perform from an environmental perspective. These requirements enable us as managers to consider short, medium and long term action plans to enhance performance and mitigate risk from associated challenges that may incur financially material risks. Looking towards the future with the opportunity set and technological developments that include smart building solutions, reduced embodied carbon and sustainable building practices, its clear that green buildings provide significant potential to measure the impact not only on our ecosystem, but for the people that occupy those buildings and the performance that is delivered on behalf of clients.

“How does investors financially benefit from decarbonizing real estate?”

NREP

We believe decarbonizing real estate assets will create value both directly and indirectly. We expect direct value creation from cost savings due to more efficient use of resources, such as energy and building materials. We see strong indications of value creation across our value chain from wider access to investment opportunities, lower vacancy, increased leasing velocity, higher rent, higher exit valuation, better access to financing and more attractive financing terms. We believe decarbonization is good business and that it will increasingly become a license to operate in the urban environment.

Fidelity

All buildings are subject to transition risks as well as physical risks, which directly link to climate change. Everything else being equal, investors in buildings with green credentials should benefit from a “green premium” through the prospect of higher and more stable rents, lower vacancy rates, and increased asset valuations.

We believe refurbishing existing buildings offers a scalable way of lowering emissions when urgency is needed in managing the climate crisis. On average, a refurbished property will have just 60% the embodied carbon of a new green building, with a lower financial cost and reduced construction risk.

Fidelity’s real estate team believes asset owners should follow a whole life cycle approach to decarbonisation, from acquisition to disposal. Central to each stage should be a net zero carbon plan, priorities to decarbonise on a science-based pathway, and engagement with key stakeholders to meet emissions reduction goals.

Invesco

We believe that the integration of ESG in real estate and decarbonization of the sector can not only enhance value but mitigate risk for a more resilient portfolio for the benefit of investors. From an income perspective, both through market studies and existing portfolios, clear evidence demonstrates that this forward-looking approach results in higher rents achieved in buildings with leading sustainability credentials that demonstrate reduced operating costs and healthier environments, lower vacancy rates and downtime between tenants for buildings meeting desired criteria, and consistently lower cap rates for buildings that are energy efficient and less need for tenant incentives. As for expenditure, reduced opex from strategic asset plans and lower cost of debt are beneficial for investors when implementing these solutions for a future proofed portfolio. Additionally, some jurisdictions provide tax breaks and incentives for green buildings, which provide additional benefits to investors. Finally, as a means to manage risk, decarbonizing real estate reduces the potential obsolescence of older building stock to meet the increasing market and tenant demand, improved insurability of resilient buildings and reduced liabilities from regulations imposed by governments as a result of stricter building environmental performance standards. Increasing income by providing sustainable and efficient assets, decreasing costs through strategic asset plans, lead to better net operating income and ultimately enhancing value of properties to improve returns for clients.