MEMBERS AND INDUSTRY INSIGHTS

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SIOR® EUROPEAN REGIONAL CHAPTER

FOREWORD BY EUROPEAN CHAPTER PRESIDENT

A year on from COP26 SIOR Europe members are keen to share their insights into the industry and trends they've observed following the conclusion of COP27.

Whether as a result of COP26, or because of other external geo-political and macro-economic pressures, over the last year there has been a massive rise in the number of businesses interested in transitioning towards low carbon solutions, as well as significant ramping up of renewable energy sources, with commitments to phase down fossil fuel reliance really making a difference. This newfound urgency has translated in a dramatic increase in financing.

We anticipated that this period of 'transition' was going to be a key focus through the majority of the COP27 sessions. It emphasises the need for the benefits of a green economy transition to be shared widely, supporting those who stand to lose economically (i.e. through moving away from coal to renewables) while also protecting vulnerable communities, companies and industry.

Real estate is one of the largest contributors to greenhouse gas emissions, however, one of the most effective ways for any business to reduce its carbon footprint is to move to more energy-efficient, sustainable buildings. It is therefore no surprise that mid and large size businesses – especially those that operate from a network of properties – are employing sustainability consultants, either in-house or externally, with increasing frequency, to advise on ways to "decarbonise" their business and shape their accommodation strategy.

The need for retrofitting within the built environment is beginning to gain more traction, and this was a talking point during the decarbonisation and solutions days.

That this trend has continued to accelerate despite a backdrop of headwinds related to the war in Ukraine, the associated energy crisis, food and commodity price rises, spiralling inflation and interest rates, and turbulent financial markets speaks volumes to the newfound resilience of the sustainable finance market. And though there is the ever-present risk of losing momentum, we expect the emphasis on net zero targets to continue as the market will continue to evolve, innovate, and adapt in response to new challenges.

However, there remain a number of substantial challenges that are notably absent in the news report, such as the difficulties in integrating developing world countries to western centric ESG solutions and strategies. Another challenge we must do more to tackle is finding the means to finance the retrofitting of swathes of older buildings in a sluggish market. With borrowing and material costs increasing, it is no surprise that developers and investors are prioritising flagship assets and prime locations, however we cannot forget older buildings, and we need legislation to help environmentally friendly developers introduce life cycle assessments.

The bottom line, however, is that the world remains on course for around 2.5 degrees of warming, significantly higher than the 1.5 degree pathway. This is hugely concerning and exacerbates our need for radical collaboration as we need to raise our collective ambitions to cut harmful energy and get back on track. And we also need more in the way of support, policies and regulations from governments to help get possible solutions off the ground.

We hope that the notes that follow from our members, all best-in-class experts across Europe, can help contribute to the ongoing ESG conversation, while also highlighting the key responsibilities of businesses operating in the built environment and the leading role we can all play in building a more sustainable future.

Andrew Smith SIOR FRICS
Partner, Carter Jonas
Andrew.smith@carterjonas.co.uk

INDUSTRY INSIGHTS OVERVIEW

With thanks to:
Renata Osiecka SIOR, MRICS, Managing Partner, Axi Immo
James Mulhall SIOR, MSCSI, MRICS, Managing Director, Murphy Mulhall
Matt Swash SIOR, MRICS, Senior Director, NAI UK
Michael Pain SIOR, MRICS, Head of Tenant Representation Team, Carter Jonas LLP
Tobias Schultheiß SIOR, FRICS, Managing Partner, Blackbird Real Estate GmbH
Fabian Mühlen SIOR LL.M. MRICS, Partner, DLA Piper
Dr. Martin Greiner SIOR, FRICS, CFA, Head Investment Advisory, SPGI (Zurich) AG
Anna Tsartsari, Director ESG and Sustainability, BE Design

During COP26 countries agreed to revisit and strengthen their 2030 reduction targets to make sure each were aligned to the Paris Agreement. Over the past 12 months, 24 of 194 countries have come forward with new or updated targets, while Climate Mitigation, Resilience and Adaptation are now also key focuses to reduce, plan and protect against extreme climate risks and vulnerabilities.

The Climate Data Steering Committee, launched in June 2022 by French President Emmanuel Macron and United Nations Special Envoy for Climate Ambition and Solutions Michael Bloomberg, outlined the next steps for its Net-Zero Data Public Utility at COP27 for technical resources to build the first-ever openly-accessible data platform that will collect, aggregate, and standardise net zero data for companies' climate pledges. This will enable investors, regulators and the general public to track and scrutinise the progress made by companies on their net zero targets.

Increasing investor scrutiny

Over the last year, the strongest theme to emerge from both the UK and Europe has been the hard-line that stakeholders have increasingly adopted towards ESG credentials. This has proved to be a catalyst for change, and investor scrutiny has driven ESG issues to the forefront of businesses minds, and they have ramped up their sustainability credentials as they seek to attract investment.

We anticipate that this trend will only accelerate following proposed plans at COP27 by the Climate Data Steering Committee – a global group of public and private sector leaders – for an initiative for technical resources to build the first ever openly accessible data platform that will collect, aggregate, and standardise net zero data for companies' climate pledges. This platform would enable investors, regulators and the general public to track and scrutinise the progress made by companies on their net zero targets.

Across the board, our members are seeing greater demand, and incentives, for certifications like BREEAM and LEED, and banks have gone so far as to prepare separate loans to developers looking to fund green projects, and further measures going so far as increasing the taxation of non-green developments.

Occupiers prioritising cost savings

Over the last year, occupiers have put savings at the top of their agenda, and while in the past that might have seen ESG relegated to the bottom of the list of priorities, this mindset has shifted. Occupiers are now preparing surveys of consumption and energy efficiency and see going green as a real viable and commercially sound solution towards curbing energy use and reducing costs.

What is especially encouraging is that going green has become the norm for new buildings, and office developers and even industrial players are prioritising sustainable criteria as an essential pre-requisite which their occupiers and investors will demand. Nowhere is this more apparent than in the office space, where new and ESG focussed buildings are in high demand, but 'secondary' office space is still struggling to recover and attract occupiers back following the rise of the work from home phenomena. However, following in the footsteps of the office sector we are now seeing the focus shift towards industrial buildings, and we expect that activity in this area will continue to accelerate.

Demand for tech and expertise outpacing demand

The adoption of new technology is starting to outpace demand, with photovoltaic developers in particular enjoying a huge influx of business, to the point that its increasingly difficult for them to find the time and resources to cater to everyone. Property developers are even having to start their own solar businesses or resorting to bringing solar developers into joint venture projects.

On top of this, adoption has been hampered by a shortage of in-house expertise for a lot of real estate companies, especially those with large property portfolios, whether that is in the decisions they make, or how their facilities operate. This is very difficult to deliver cross-border, given the differing employee needs, business cultures and legislative guidelines. While there is a real effort from companies to upskill their employees, there remains a large demand for specialised tenant representation and brokers to provide the 'in market' guidance that ensures they can make the best decisions at a transactional level.

Geopolitical and macro-economic trends still threaten to derail momentum

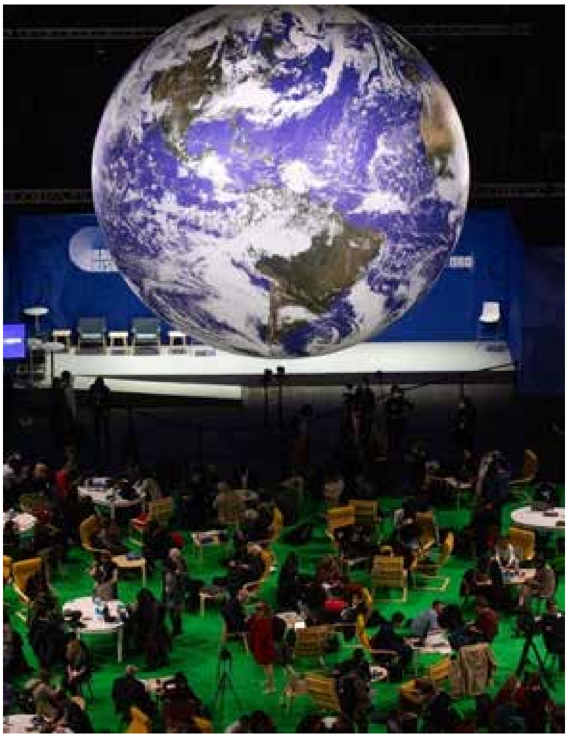
While net zero pledges and targets are also progressing significantly since COP26, going from 600 companies to 1,400 at the end of September 2022 and an additional 7 countries signing up to net zero carbon goals. We cannot ignore the potential danger in the current geopolitical and economic environment that is affected the mood at COP27 and were large contributing factors in reducing the aims and objectives from the conference.

The movement is also at risk of fracturing. Too many of our solutions overlook the developing world and we should be doing more to bring them into the fold. We need to be more open-minded towards research and technology to produce solutions everywhere, not just in our sphere, or we may find that the developing world will be unable, or unwilling, to follow the Western example on the required scale. We need to do more to integrate other parties or see our own efforts rendered pointless.

Fundamentally, financing underpins the commercial property market and there is an argument to suggest that with growing interest rates and cost of materials, investors will shy away from the risk and the pioneering design needed to reduce the built environment's carbon footprint.

However, the war in Ukraine has ironically also served as an accelerator to incentivise the shift from gas & oil to more renewable forms of creating energy. Photovoltaic and wind have notably seen booming demand, as more and more developers shift to refurbishing existing buildings rather than demolishing and rebuilding at a massive cost in embodied carbon.

To sum up, there remain many complex and difficult challenges to overcome, and our members are greatly encouraged by the huge steps the industry has taken over the last twelve months in adopting ESG solutions. This a good start, but there remains a lot to do. The clock is not only ticking for the planet but for the many landlords of buildings with poor environmental credentials, and they must get on board if they are to avoid incurring potentially very significant income voids in their investment portfolios.



Poland

By Renata Osiecka SIOR, MRICS, Managing Partner, Axi Immo

Awareness of climate change has markedly improved with clients, and businesses are trying to adapt their operations to be greener. ESG strategies in Poland still heavily focus on the Environmental aspect ahead of Social and Governance. We are seeing the large-scale adoption of solar technology on new warehouse projects, with developers also emphasising the presence of greenery near facilities and favouring more open spaces as wellbeing is also increasingly becoming a factor.

As with almost everywhere in Europe, the Polish market is urgently seeking solutions to the energy crisis to combat galloping inflation and rising construction costs.

Ireland

By James Mulhall SIOR, MSCSI, MRICS, Managing Director, Murphy Mulhall

On the surface the built environment has no shortage of flagship new builds embracing the principles of ESG and energy efficiency, however in real terms, Ireland is still ignoring older building stocks that cannot find the necessary investment to be retrofit.

In addition, a large section of the occupier market remains unconvinced about the financial benefits of adopting ESG policies and initiatives, and this coupled with cynicism about the merit of sustainability accreditation, means that there remains a lot of work to be done.

We need to be doing more to champion the benefits associated with ESG and how these initiatives can have a quantifiable impact on operating costs and making the accreditation of sustainability badges more transparent.

REGIONAL SPOTLIGHT

UK

By Matt Swash SIOR, MRICS, Senior Director, NAI UK and Michael Pain SIOR, MRICS, Head of Tenant Representation Team, Carter Jonas LLP

At COP26 the UK committed to cutting emissions 64% below 2010 levels, and following the conference members of the Glasgow Financial Alliance for Net Zero collectively committed 130 trillion USD of private finance towards science-based net zero targets.

Elsewhere in the UK an increased focus on ESG from occupiers, and especially investors, has led to many businesses establishing internal ESG teams to put sustainability at the top of their agenda.

The UK Environment Act became law in November 2021 (announced around COP26) also attempt to tackle the long-term targets of air quality, biodiversity, water and waste reduction. There are calls from industries and sectors for this to evolve further due to a lack of clarity. From a built environment perspective, the BREEAM and WELL Building standards assessments we provide are a way to help companies reach their individual targets or goals set as part of green financing, investment criteria etc.

Five years ago, ESG was a 'nice to have', but post pandemic we are seeing a 'flight to quality' from occupiers of both office and logistics space, with sustainability now an essential part of this process.

Meanwhile, the hybrid working trend has led to businesses 'right-sizing', as they take less space, but increasingly prioritising spaces that align with their ESG objectives. This has led to a disparity in rents that are being achieved on the lettings of energy-efficient buildings with good green credentials and lower grade properties, and this gap has continued to widen over the last 12 months.

The Government's commitment to 'Minimum Energy Efficiency Standards' is starting to have a profound impact on both occupiers and investors. From 2027, buildings must have an Energy Performance Rating of 'C' or higher, with this increasing to 'B' from 2030. At present, only new or refurbished buildings generally achieve these levels. Should buildings fail to comply, they will be unable to be let which creates challenges for their occupiers and/or owners. The cost and logistical impact of this could be huge and redefine the landscape of the UK's commercial property market.

In a real estate market where businesses are becoming ever-more environmentally aware, landlords of buildings with poor sustainability credentials will need to raise their game significantly.

Germany

By Tobias Schultheiß SIOR, FRICS, Managing Partner, Blackbird Real Estate GmbH and Fabian Mühlen SIOR LL.M. MRICS, Partner, DLA Piper

Despite energy costs rising by up to five times more expensive than a year ago, unlike the Anglo-Saxon countries, Germany has been slow to react to market changes. While it is true that landlords have been under rising pressure to reduce costs, and the county has not been immune to the market irritations caused by the war in Ukraine, inflation and rising interest rates, the effect on commercial values has not been felt as strongly yet.

With that said, we have noticed that landlords have been investing heavily into solar energy solutions to bring down costs. However, this has created a divide between buyers and sellers. With institutions here expecting higher margins, more equity, and repayments, this has resulted in rising capital costs for buyers with sellers unwilling to reduce their prices, resulting in a lot of deals failing to complete.

CONCLUSION

Key takeaways from COP27

By Paul Danks SIOR FRICS, Director DRG Group and SIOR Board-International Representative

Two of the big questions to come out of COP27 were how to better tackle decarbonisation while also wrestling with the growing problem of greenwashing.

A study released at the conference highlighted that at current emission rates, there is a 50% chance that global warming will exceed the 1.5°C limit within the next decade, which puts further pressure on the built environment, responsible for 40% of emissions in the UK alone, to continue to develop technologies to halt this alarming slide.

However, the public mood has grown ever more cynical towards the climate conference, with Greta Thunberg notably boycotting the event and calling it a forum for greenwashing, while the BBC reported on the growing number of delegates from oil companies. Though this in itself is no bad thing given the ability of the sector to invest billions of dollars in the transition to "green" energy.

This poses a difficult conundrum as while we do not want to discourage any initiatives that contribute towards reducing carbon emission goals, at the same time we have to call out those instances of tokenism and virtue signalling or risk the debate around greenwashing becoming an unwanted sideshow that will continue to undermine the industries wider efforts to achieve carbon neutral goals.

The construction sector in particular was in the spotlight with the sourcing and types of materials used in construction coming under heavy scrutiny, as general contractors and developers look for more sustainable sources of cement, concrete, and timber and put greater emphasis on reducing the embodied carbon imprint of buildings.

There was also a lot of talk about the need for more collaboration, especially in cities which are some of the biggest emission hot spots and where we need to not only reduce emissions but also improve biodiversity and provide more eco-friendly transport links including better infrastructure to help support the switch to electric vehicles.

Meanwhile, and similarly to the greenwashing problem, the issue of sustainability is becoming ever more entangled with politics. Many politicians and pundits in the west have been very vocal about their opposition to financial aid "reparations" towards particularly developing nations bearing the brunt of climate impacts. Some framing these subsidies as a "scam" at the expense of tax payers. While these views have started out at the fringes, they are finding increasingly more traction, particularly in America and could pose a long term threat to achievement of sustainability targets.

However, despite these difficulties the mood in the industry still seems unified in purpose, and there's a real willingness in the sector to overcome these challenges and press on with meeting our sustainability targets. In fact, there were a lot of encouraging signs to come out of COP27, however the real litmus test will be in the year ahead when we see the measure of how far government legislation and particularly business are prepared to go in both measuring and reducing their carbon footprint across their total supply chain to achieve net zero targets.

Paul Danks, SIOR, MRICS
paul@pdanks.co.uk