

Asset Management

SAVING THE ENVIRONMENT AND IMPROVING YOUR PORTFOLIO WITH REAL ESTATE

THE RIGHT REAL ESTATE INVESTMENTS CAN HAVE A SURPRISINGLY POSITIVE IMPACT ON THE ENVIRONMENT

Buildings account for about a third of total carbon emissions globally. This presents a real opportunity for investors who seek to maintain a diversified portfolio and contribute to improving the environment. The most sustainable real estate companies may also turn out to be high performing real estate investments. Northern Trust Asset Management's Mamadou-Abou Sarr, global head of ESG, and Julia Kochetygova, senior ESG research analyst, explain.

WHY IS REAL ESTATE SUCH A LARGE CONTRIBUTOR TO GREENHOUSE GAS EMISSIONS?

KOCHETYGOVA: Buildings use electricity for lighting and cooling and they use fossil fuels for heat, making the real estate sector a significant energy user and greenhouse gas producer that contributes to global warming. Globally, building operations and construction account for about a third of total carbon emissions. Therefore, energy efficiency becomes a top sustainability issue in this sector.



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AND WHAT ARE OTHER ESG ISSUES THAT THIS SECTOR IS RESPONSIBLE FOR?

SARR: Real estate companies are responsible for affordable housing, safety, the well-being of tenants, employees and communities surrounding their assets. These are significant social issues. There is a strong connection between health and the indoor spaces where we spend most of our days. Also, many real estate companies are involved in new construction or remodeling, where safety is a top issue. Investors have the opportunity to require that real estate companies follow responsible social and environmental practices that improve the quality of their buildings and lead to financial success.

DO SUSTAINABLE REAL ESTATE COMPANIES DO BETTER THAN THEIR LESS SUSTAINABLE COUNTERPARTS?

SARR: An interesting 2015 study¹ in the *Journal of Portfolio Management* found that buildings in North America with sustainable practices had higher rents and occupancy than buildings without them.

KOCHETYGOVA: When a property is positioned for sale, sustainable measures such as better indoor environmental quality, onsite renewable energy and efficient lighting, heating, ventilation and air conditioning systems can be leveraged to enhance the property's marketability and maximize value. These measures will also reduce the property's expense ratios over the holding period, which benefits owners and tenants.

IS THERE INTEREST FROM INVESTORS IN REAL ESTATE INVESTMENT TRUSTS (REITS) WITH AN ESG FOCUS?

KOCHETYGOVA: We have seen strong interest from investors to understand which companies have sustainable practices in this sector. We believe sustainable practices not only have a big impact on long-term financial success, but investors also are concerned about how their investments reflect on their reputation and duties to their clients.

SARR: Even more, investors want to use robust and independent assessments of the ESG quality of companies. This is particularly important for the listed real estate investment trusts, the primary option for equity investors to get exposure to property assets. Back in 2009, a group of large pension funds started the Global Real Estate Sustainability Benchmark (GRESB) — an industry-driven organization responsible for



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¹ Nils Kok and Avis Devine. "Green Certification and Building Performance: Implications for Tangibles and Intangibles". *Journal of Portfolio Management*. September 2015. The study found that LEED and BOMA BEST certified buildings in the U.S. had net effective rents 3.7% higher than similar non-certified buildings; occupancy rates were 18.7% higher in Canadian buildings having both LEED and BOMA BEST certification, and 9.5% higher in U.S. buildings with ENERGY STAR certification, than in buildings without certifications; and energy consumption per square foot was 14% lower in U.S. LEED certified properties than in buildings without certification.

assessing and rating the ESG performance of listed and private real estate funds.

HOW DOES GRESB RATE THE COMPANIES THEY CONSIDER?

KOCHETYGOVA: Each year, GRESB invites real estate companies to participate in a questionnaire to assess their ESG practices. They ask about the policies and principles real estate funds use to make decisions and metrics that show how decisions and plans are put into effect along with the results.

SARR: With the information from the questionnaire, the firm evaluates real estate funds, ranks them and assigns ratings of 1 to 5 based on their rankings. The top rating of 5 stars means the real estate firm is in the top 20% of the ranking, while 4 stars is next 20% and so on. The GRESB assessment provides the basis for the systematic evaluation of investment strategies.

HOW CAN INVESTORS GET EXPOSURE TO SUSTAINABLE REAL ESTATE?

KOCHETYGOVA: Historically, to get exposure to responsible or sustainable real estate companies you would have to hold physical assets or use an active fund. Now, through collaboration with GRESB and Thomson Reuters, Northern Trust Asset Management has created a [Developed Real Estate ESG Index](#) administered by Thomson Reuters. This index is exclusively available to Northern Trust investors either through a cost effective and transparent [UCITS fund or using a separately managed account](#). This allows investors to combine Northern Trust's nearly three decades of experience in sustainable investing, the unique expertise of GRESB in assessing real estate investments, and the robust index services of Thomson Reuters.

HOW IS THE NORTHERN TRUST GRESB DEVELOPED REAL ESTATE ESG INDEX BUILT?

SARR: In order to get included into the Northern Trust GRESB Developed Real Estate ESG Index, companies need to report to GRESB at least once in the last three years and not receive the lowest rating of 1 star. They also must pass stringent index liquidity and investability criteria.

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