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Sustainability as a path to profit was once a pipe dream, but investor demand for green developments is now making it a reality.

Illustration by Helena Perez Garcia, Spain

Following the money

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> *"The fundamental value proposition recognises that if capital expenditure is deployed to deliver an asset that is as low-emissions as possible, the operational spend on energy and on carbon offsets will be less. Zero carbon starts with shrinking footprints – not just buying offsets."*

Sustainability, once a fringe issue for developers, is now a core element of asset design, delivery and operations. As we head further into the 2020s, neglecting or overlooking sustainability has ceased to be an option; it would be like trying to run a business using only landlines and a fax machine.

Various forces have driven the shift to sustainability in development, including obvious 'pull factors' such as scientific evidence about the likely effects of climate change, and government regulation. Ultimately, however, it's been the power of money that has tipped the scales. When clients with money start pushing for sustainability, industry surely follows.

The shift hasn't happened overnight. When the concept of environmentally sustainable development (ESD) first emerged in the early 1990s, it was considered merely 'nice to have' – a bonus optional extra. By the early 2000s, discussion around the issue centred on the return on investment (ROI) and the relationship between improving building performance and reducing spending on energy and water bills. ESD proponents had to show it would pay off.

At around the same time, green building rating systems emerged, luring developers with the offer of street cred with a shiny badge. The first four-star, five-star and then six-star buildings generated property media publicity, kudos for design teams and developers, and delivered green glory for anchor tenants.

In 2008, the Global Financial Crisis saw many development plans shelved. For projects that did proceed, the imperative shifted to delivering results as cheaply as possible – and ESD often became a casualty. But as the global economy recovered, and clients regained an appetite for competitive difference and green credentials, developers began to see value in sustainability again.

The UK and Europe supported this shift with regulations lifting building standards and setting requirements around asset performance and emissions reductions. Australia, meanwhile, settled on market-driven competition supported by measures including mandated energy efficiency disclosure for commercial buildings, and a raft of building energy efficiency requirements outlined in Section J of the National Construction Code.

Behind the scenes, global capital was also reframing its priorities. The rise of shareholder concerns about carbon emissions, human slavery in supply chains and social inclusion put ESG (environment, social and governance) onto annual general meeting agendas. The Taskforce on Climate-related Financial Disclosures (TCFD), the Investor Group on Climate Change, the Global Reporting Initiative and the Global Real Estate Sustainability Benchmark all provided investors and portfolio owners with scorecards and forums for measuring themselves against their peers.

Today, the conversation has shifted further. It's no longer about the 'why' of sustainable building; that's now a given. The starting point is 'how'. And as sustainability becomes business as usual in design, engineering and construction, expect to see the ripple effect on supply chains in other industries such as manufacturing and logistics.

TRILLION-DOLLAR DRIVERS OF CHANGE

Pension funds are highly influential players in global finance. At the end of 2021, the OECD[1] estimated the combined capital of the world's pension funds amounted to more than US$35 trillion (AU$48 trillion). Australia had the fourth largest national pension fund pool, worth approximately AU$2.7 trillion, outranked only by the US, the UK and the Netherlands.

With their huge resources, pension funds (or superannuation funds, as they are usually referred to in Australia) have long been a significant source of capital for developers. And now that the funds are increasingly inclined to invest in projects with verifiable sustainability credentials, developers are having to step up.

In this rapidly changing environment, investing in projects and enterprises that 'do good' for the world has become not just a necessity, but an advantage. As a result, pension funds have increased their focus on a broad range of ESG-related risks for companies in which they invest, including potential energy price rises, climate impact exposure, carbon pricing mechanisms, workplace health and safety, modern slavery and other unethical practices.

The shift towards more social responsibility in business and finance has been manifested in other ways too, including the increased availability of competitive finance and lower interest rates for projects with integrated sustainability. With debt raising easier, and lower interest reducing pressure on timelines and bottom lines, developers are taking note – and their chief financial officers increasingly have environmentally sustainable development at front of mind when doing cost-benefit analyses.

It's a win-win scenario for everyone from investors, funds, finance companies, insurance companies, developers, designers, engineers, builders to those who live, work, learn and play in our buildings. It is changing our built environment – and the natural environment – for the better.

ESD: HOW IT WORKS

If you take a normal development, then add sustainability, it is worth more to lease or to sell. And because investors ultimately want higher returns, they are driving our design and construction industries harder to achieve higher returns through sustainability.

In the process, investors are doing more due diligence. This means it is not enough to just look at a shiny sustainability report on a developer's website and accept it at face value; investors want to see actual results and metrics such as carbon accounting and ratings based on objective global and national benchmarks. These profound cultural and behavioural changes in the professional investment community have made greenwashing an increasingly risky path for developers, and have therefore changed the landscape of the whole industry.

How does the government policy fit into this? In Australia, our national government is clearly not providing sufficient leadership on sustainability and climate change. Thankfully, however, momentum on these issues continues to build in the private sector, with big pension funds among those leading the push.

INSURERS GETTING SMARTER – AND GREENER

Some of the world's biggest insurance and reinsurance companies, including Swiss Re, Zurich and Lloyds, have identified climate change as a real and immediate global risk. To meet the challenge, they've been putting policy and governance measures in place to reflect both the degree to which certain assets are exposed to climate risks, and the extent to which some assets might also contribute to climate risks. Carbon-intensive industries such as coal mining therefore face increasing challenges when it comes to getting insurance.

In addition to taking practical measures, many global institutions are also becoming outspoken about their positions on climate change and sustainability. For example:

- Ratings agency Standard & Poors now integrates ESG indicators into its credit ratings.[2]
- Insurer Munich Re has stated that climate change is "one of humanity's greatest challenges".
- Rival insurer Swiss Re has announced its plan for a total phase-out of thermal coal-related business in OECD countries by 2030[3]
- Lloyds announced in October 2021 it was moving all its operational and attributable emissions to net-zero by 2050 or earlier, and would transition its GBP3 billion Central Fund to net-zero emissions by switching to green investments.[4]

THE NEXT FRONTIER: SOCIAL GOOD

Having integrated environmental concerns into their decision-making processes, many investors are looking at further ways in which they can have a positive influence on the world. For some, that means focusing on the 'S', or social, in ESG. However, not all big investment funds are new to this idea. GPT, for example, has always incorporated a requirement for a major positive social impact into its developments. In doing so, it has raised the bar for other retail centre investors and developers, particularly in regional and disadvantaged communities. Social benefits are also accounted for in ratings systems including Green Star and Leadership in Energy and Environmental Design (LEED), and the Living Building Challenge.

There are also tools for businesses to assess their own social benefit, such as the JUST rating system from the Living Future Institute, which Cundall has used to help understand and enhance our operations and how we care for our people.

On another front, concerns around slavery have become mainstream, with specific legislation passed in nations including the UK and Australia requiring large companies to report on modern slavery risks in their supply chains.

Fair Trade is another concept that has gained rapid momentum, recognising that the relative wealth and affluent lifestyles of a few cannot be based on the exploitation of people who grow our coffee and cocoa beans, harvest and process our cotton or make our shoes and sporting goods. This focus aligns with another set of global targets contained in the UN Sustainable Development Goals. The integrated and holistic nature of these goals is something we increasingly use when planning net-zero and ESG strategies for clients and projects.

WE CAN GET THERE

With ESG now a core concern for global capital and zero carbon emissions officially our collective target, the property industry and its professional allies, including designers and engineers, are scrambling to get there quicker, faster and better.

The fundamental value proposition recognises that if capital expenditure is deployed to deliver an asset that is as low-emissions as possible, the operational spend on energy and on carbon offsets will be less. Zero carbon starts with shrinking footprints – not just buying offsets.

As an industry, this is our shining moment. While clients might set the goals, they need us to come up with the means to get there. — ●

1 www.oecd.org/finance/private-pensions/Pension-Funds-in-Figures-2021.pdf

2 www.spglobal.com/ratings/en/products-benefits/products/esg-in-credit-ratings

3 www.swissre.com/risk-knowledge/risk-perspectives-blog/only-sustainable-business-is-good-business

4 www.reuters.com/business/cop/exclusive-lloyds-london-ups-climate-pledge-push-members-net-zero-2021-10-27

LINKS:
cundall.com

ABOUT
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Julian Bott started his career as a building services mechanical engineer, working on complex commercial, retail and data centre projects. He joined Cundall in 2005 and became an early pioneer of environmentally sustainable development (ESD) in Australia, before moving to Hong Kong to establish a Cundall office there in 2008. Now based in Sydney, he is focused on delivering projects with a strong focus on sustainable design and technical excellence.