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Insights into the impact of ESG on offices

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Shoosmiths is a law firm assisting clients in delivering ambitious commercial and residential real estate projects, including urban regeneration, major funding and investment deals, and the creation of thriving new locations.

We asked Liz to share her insights on the impact of ESG on the office market.

How important is ESG to investors in the office market?

"It's very important. In fact, it's critical. There are many surveys now where a high proportion of investors state that the non-financial performance of the asset is pivotal in their investment decision-making. We're all aware of the debate about stranded assets and making sure that your portfolio is high-quality and able to be let.

However, it's important to remember that ESG is not just about the 'E'.

Of course, investors and occupiers want to ensure they are delivering energy-efficient spaces with a minimal, or even positive, impact on the environment. But customers also want the 'S' in ESG and the social spaces and amenities that come with that. It's about providing space that makes going to the office worthwhile – 'earning the commute', which I think sums it up well."

You spoke about 'earning the commute'. What exactly does that mean?

"It's about making it worthwhile to leave the house and go into the office.

That might mean providing social and collaboration space to work with colleagues, or even facilities to go and get a great coffee, or having dedicated client space, or that pod where you can go and make a private call, while having that focussed time.

And when it comes to the social side, it's also about having offices in places where you can go out with colleagues after work and catch up in a more personal way – something you wouldn't have if you were sat in the living room or at the end of the bed doing work."

And is this something you've seen quite recently? Or has it been on the agenda for a while?

"This is becoming more prominent. Initially ESG was about the environment and tackling climate change, but one of the things that tenants are now demanding is that social space. I would say that's quite high up their priority list, especially post-Covid. It is also key to attracting and retaining talent for employers.

What's also interesting is how you measure that. What does success look like? There are various ways progress is trying to be measured, whether it's employment levels, or around the circular economy with having people shopping, working and living in an area, or engagement with the local community and whether amenities can be used outside of office time to be able to generate that social space."

In terms of the 'E', what are investors demanding in terms of frameworks and standards?

"There are so many frameworks and accreditations, which makes it challenging to identify a single 'go-to' standard. EPC ratings seem to be the current 'go-to' in the absence of anything better, but they may not be the most effective way to measure a building's environmental performance given they are based on predicated or designed performance rather than operational and actual performance."

More broadly, what are you seeing in terms of the market impact of ESG. Are we seeing flight to quality? An increase in repurposing? What's happening in the market?

"It's a mix like it always has been. There is, however, a flight to quality.

If there is a prime building, then that's what many occupiers or investors will want to meet their own ESG credentials and as a result there is a green premium that's being paid for those buildings. But, at some point, that green premium is going to become the norm.

We are also seeing a maturing debate about redeveloping offices versus retrofitting offices. Initially the focus of the conversation was about reducing embodied carbon and how you should always try to retrofit buildings to limit embodied carbon.

But now the conversation has moved on, and there is a more sophisticated conversation about how it may be better to sometimes redevelop and redirect some of that embodied carbon into recycling or reusing some of the materials and having a new development that has a much-reduced operational carbon footprint.

Each building needs to be considered on a case-by-case basis. But we do have clients that are looking for so-called brown buildings because they can add value back into them by redeveloping them. The main blocker here is the planning process and costs."

Is there a risk that we may end up with a two-tier market?

"Yes, that is a risk. And the new minimum energy efficiency standards (MEES) may not help this, as if you can't legally let a building that will result in a wave of stranded assets. There is even a risk of a three-tier market, where you have those at the prime end and in tip-top condition, those in the middle but where there's a brown discount, and then those that are stranded and can't be let and need redevelopment."

Moving on to challenges, what challenges do you hear from clients?

"There are many, but data is one. There are challenges around data sharing from both the owner and occupier side. The more information you have, the more likely it is that you can improve the energy performance of a building.

For a long time, the need for data was about compliance and having the data to satisfy various requirements, whereas now it is as much about understanding what the data is telling you and implementing a strategy around that."

On data, sometimes green leases can be a tool to encourage data-sharing. How do you find green leases?

"There are still challenges with green leases and how dark or light green they are, but it is highly unusual to have a lease with no green provision in it. Before, you might get a line in a report stating that there are no green lease requirements, whereas now, if they're not there, that's a problem and certainly there would be some uncomfortable questions from any purchasers, for example.

It's no longer the case that green leases are fashionable, they're extremely important from an investment point of view."

What else are you seeing from investors?

"We are seeing more investors now considering not just how they cut emissions, but also how they will delivery power for their developments and buildings.

We have investors looking for on-site generation solutions, which is part of the retrofit of the building. For example, making sure the building is structurally able to take the PV panels that are going to be put on the roof.

We also have clients that enter into Corporate Power Purchase Agreements (CPPAs), where they enter into a contract with a renewables developer and agree that they will buy power at a fixed price from that renewable energy generator that will supply their portfolio or part of their portfolio.

A lot of occupiers and investors want to be able to demonstrate to the market that they are doing the right thing and are sourcing clean energy. That's a definite trend and we are supporting more and more clients in relation to this."

What's behind that? Is it just a concern that the grid can't cope. Or the need to evidence that the energy is renewable? Or about viability, making money and cutting bills?

"It's all of these. You can generate an income stream, but there is a well-publicised and genuine concern that the grid can't cope. The grid needs to decarbonise and if the real estate sector can be more self-sufficient by generating renewable energy and supplying that to buildings, then that is a good outcome."

What is the BPF Net Zero Pledge?

The BPF Net Zero Pledge commits BPF members to be net zero carbon by 2050 at the very latest. Becoming a signatory to the pledge requires three actions:

1. To sign up to net zero targets and plans
2. To commit to sharing research, knowledge and insights on an open-source basis
3. To support other signatories and the wider real estate sector to speed the transition to net zero