

Driving value

*Responsible and resilient property investing
in the new millennium*

by Molly McCabe



As chair of the Urban Land Institute's Responsible Property Investment Council, I often get eye rolls or quips such as, "Responsible property investing? If you're investing 'responsibly,' are you suggesting that we're investing irresponsibly?"

There's no moralizing here. The term "responsible" simply addresses our ability to respond. As investors, we can only react appropriately if we

understand the full nature of risk and opportunity. In our experience, a holistic lens provides an insightful risk-management tool and drives superior value. Our objective, like that of most investors, is to create competitive and durable market-rate returns.

Buildings, neighborhoods and cities are complex, adaptive systems. We see the convergence of rising urban populations, unprecedented

displacement and migration, demographic shifts, and growing income inequality. We see a warming climate, more extreme weather, natural-resource constraints, and infrastructure that cannot keep pace. At the same time, we see remarkable technology leaps along with a plethora of data and demands for increased transparency. Multiple factors are unfolding in tandem, which means results are often unpredictable and unforeseen relationships can play a significant, and sometimes oversized, role in our investments.

The old adage, "All real estate is local," still holds true. At the same time, we live on a single blue planet — one facing rapid and extraordinary change. What happens on a global scale is reflected in unique impacts at the local level. We must understand the risk of action, or inaction, as well as the cost and how to mitigate our exposure. A focused assessment of the geographic risks and opportunities requires both a "30,000-foot" view and more granular and nuanced evaluation. Extreme weather, for example, will increase in frequency and severity as the climate continues to warm. This will be especially devastating to emerging markets where a high proportion of assets are in low-lying, coastal areas. Some cities are beginning to be severely affected, with residents forced to relocate due to rising sea levels.

At its core, real estate is about people. At their best, buildings provide places for people to live and work in comfort, engaging their senses and creating communities that withstand the test of

time. Our business success is predicated on the long-term health and vibrancy of the cities where we invest. It is hard to imagine operating a real estate firm without taking into consideration the underlying integrity of the community. From a human context, we recognize environmental and social challenges put pressure on many cities, especially the most vulnerable and those with the lowest capacity to adapt.

Today's challenge

Too many owners and investors only look at the risks and opportunities that are close at hand — those occupying our immediate attention (new competitors, local rents, cap rates) and recent headlines (elections, interest rates, capital availability, monetary policy). If we fail to recognize the critical forces converging on the horizon, we will miss significant opportunities and expose ourselves to rising risk and volatility. To remain competitive in the 21st-century marketplace, property owners will need to incorporate environmental, social and governance factors into their investment profiles.

This is most obvious in cities that have planned for the future and focused on initiatives that offer a competitive advantage in attracting people and jobs. A wide range of sustainability and resilience initiatives can address changing climate and resource issues: a focus on walkability, transit and infrastructure; green space and livability; and affordability, housing and community engagement. We should also look at water, energy and food availability and

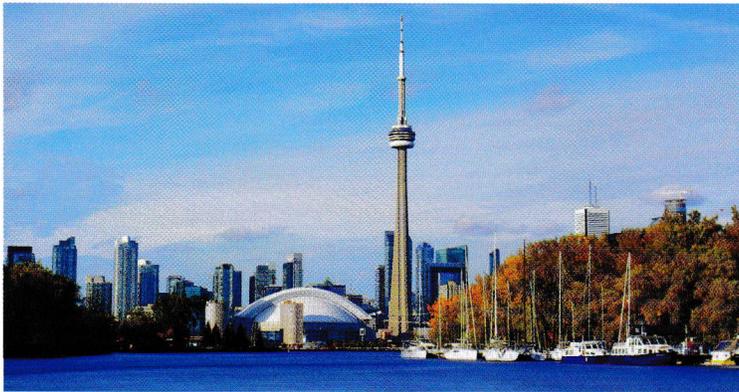
Examples of property- and climate-related efforts by institutional investors		
Organization	Objective	Commitments
Global Real Estate Sustainability Benchmark (GRESB)	Industry-driven benchmark that aims to give property companies and funds a means of assessing relative and absolute performance on ESG factors	>\$2.8t in property value, >750 participants
Greenprint Center for Building Performance, Urban Land Institute	Reduce the carbon footprint of existing buildings and enhance value in the real estate asset class by providing members asset-level and aggregated benchmarking and performance trends of energy, water and waste	>\$650b in real estate assets, >45 participants
Carbon Disclosure Project (CDP)	A globally used standard for greenhouse gas emissions reporting	>\$100t in AUM, 827 institutional investors
U.N. Principles of Responsible Investing (PRI)	Investors aim to put U.N. principles into practice, including recognition of the materiality of ESG criteria	>\$60t in AUM, 1,500+ signatories
Montreal Climate Pledge	Signatories commit to measure and publicly disclose the carbon footprint of their investment portfolios on an annual basis	>\$10t in AUM, 120+ signatories
Global Investor Statement on Climate Change (COP21)	Signatories called for stronger political leadership and more ambitious policies implemented into national laws and regulations	>\$24t AUM, 409 signatories

Sources: Various sources; adapted from *Adapting portfolios to climate change*, BlackRock Investment Institute, July 2016

costs, as well as social cohesion — how does the city treat its citizens, and how well do they interact with each other?

Canada's Toronto, Vancouver and Calgary top Grosvenor's *2014 Resilient Cities* report as the least-vulnerable and most-adaptive cities on the planet: "Canadian cities have a strong combination of low vulnerability and high adaptive capacity. There is a high level of resource availability, and Canadian cities are well governed and well planned." In comparison, some important U.S. cities rank lower due to their increasing inequality, social tension, lack of investment in utility infrastructure, and urban sprawl.

On the emerging-market side, the November 2015 JLL report, *Globalization and Competition*:



Toronto ranked as the world's most resilient city in a 2014 report by Grosvenor.

A New World of Cities, cites Taipei as one of the 10 best-performing "Emerging World Cities." It is noted for its "holistic emphasis on human-centric 'design thinking,' prioritizing user experience, sustainable architecture and 'smart' technology." Taipei has also risen in the ranks on AT Kearney Inc.'s *Global Cities 2016* outlook for future potential based on the rate of change in personal well-being, economics, innovation and governance.

Staying competitive

Reporting and transparency requirements relative to ESG are becoming far more common. The state of California, for example, recently enacted legislation to reduce carbon emissions 40 percent below current targets. This will require additional reporting and benchmarking. Policy requirements in the European Union have set a trajectory toward "net zero" for all new buildings constructed after 2018, which means owners will have to change how they build and operate property. A clear relationship exists among energy efficiency, climate change, city resilience, health and vibrancy, and attractiveness to investors. Cities that put these policy initiatives in place have signaled greater adaptive capacity.

Investors are now actively seeking ways to report their progress. GRESB — the Global Real Estate Sustainability Benchmark — has in excess of 750 participants, with property valued in excess of \$2.8 trillion. Members of ULI's Greenprint Center for Building Performance have more than \$650 billion in real estate assets under management, representing 51 countries (see table, page 47). Institutional investors holding more than \$100 trillion in assets, in aggregate, participate in the Carbon Disclosure Project. According to the United Nations Environmental Program Finance Initiative:

"[I]n order to create and sustain long-term value, and to avoid losses, many institutional investors and their stakeholders have already recognized it as their fiduciary duty to understand and actively manage these factors. By integrating ESG and climate risks into their businesses, real estate investors are better able to understand and actively manage these market shifts, including occupier preferences and changing behavior, market externalities, new regulatory frameworks, and legal requirements. Failing to consider ESG integration is a failure of fiduciary duty."

Global rating agency Standard & Poor's has warned of the risks to some sovereign credit ratings as a consequence of climate exposure, and has taken adjustments to a number of corporate ratings as a result. In September 2016, S&P Global Ratings announced it was seeking input on the development of a new ESG framework for corporate issuers. The assessment tool would:

"Evaluate a company's impact on the natural and social environments it inhabits, the governance mechanisms it has in place to oversee those effects, and potential losses it may face as a result of its exposures to such environmental and social risks."

S&P notes these environmental and social risks include potential regulation and resource scarcity/degradation. S&P also believes that, unless mitigated, these risks could weaken a company's business and financial risk profiles over time.

Responsible property investing, or RPI, is a disciplined approach that incorporates ESG criteria to optimize returns and allow investors to remain competitive in the marketplace of the future.

Quality of life

By consciously using our natural resources, reinvesting in our people and our communities, and recognizing diversity results in better decision making and stronger ties, we are ensuring a higher-quality asset. When we raise the standard

of living, we create jobs as well as healthy, safe places to work and live. This, in turn, raises the tax base; supports investment in infrastructure and community programs; and promotes art, music and education. When we create vibrant, healthy, desirable neighborhoods, we also raise asset values.

Resilient cities provide a good quality of life for their citizens. Take water, for example. When we invest in infrastructure that delivers clean and accessible water, we address gender inequality at the same time we maximize economic returns. In many countries, women are responsible for securing water, often at great personal risk. By investing in water delivery, we free time for school, which results in an educated population and reduced healthcare costs. This, in turn, results in increased commerce and benefits the entire local economy.

As real estate owners, we prosper when we support the long-term stability and prosperity of the communities where we invest. With every investment, whether of money, time or capacity, we make a clear statement. Still, we can be far more intentional with how we develop and redevelop. Mixed-income, cross-generational development supports social cohesion. Responsible contracting

ensures living wages. Renewable energy reduces air pollution and cuts sick days.

Decision time

Instead of tracking whether returns have increased over the past quarter, we need to ask whether we are building adaptable and resilient buildings, cities and systems, and whether we are creating assets that can withstand volatility and flourish given an uncertain future. When large pension funds and other institutional investors make decisions that capitalize on short-term returns to the detriment of long-term value, they are negatively affecting their returns and their profitability.

Too many investors have responded to changing conditions by narrowing their perspectives and putting their profits at risk. Our current business model, which focuses solely on extraction, is unsustainable. The healthiest plants grow in soil that has been tended and replenished. When we expand our focus, it is far easier to evaluate costs, maximize profit, and optimize our investment decisions for their long-term value. ❖

Molly McCabe is president and founder of **HaydenTanner LLC**; managing partner of **Meraki Capital Partners**; and chair of the **Urban Land Institute's** Responsible Property Investment Council.

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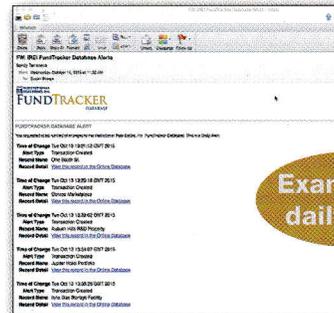
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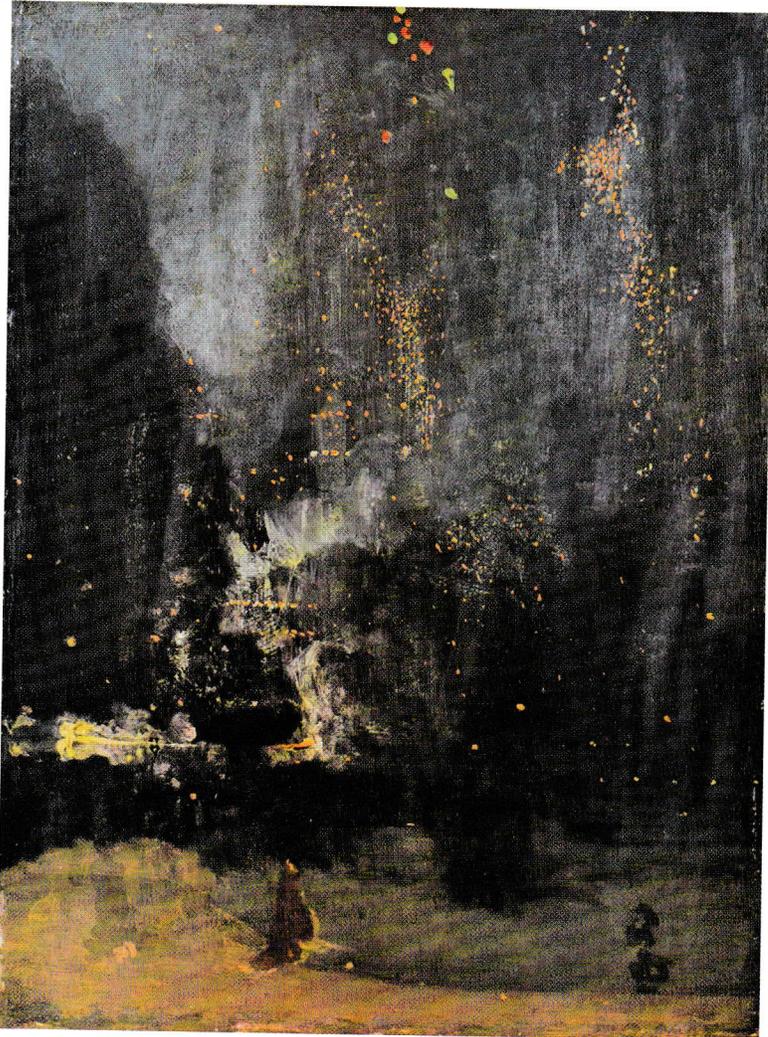
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