KEYNOTE INTERVIEW

How to avoid ESG obsolescence

As sustainability demands evolve, Yardi's Joe Consolo explains how asset owners can breathe new life into a building before it's too late

Environmental and social concerns are playing an ever-greater role in the governance and processes of the modern company. The real estate business is no exception, and owners and operators have to keep at least one eye on ESG concerns when thinking about the construction and running of buildings. The idea, however, that the environmental and social needs of investors, tenants and government regulation could drive a building to actually *become* obsolete seems hard to fathom.

Yardi's industry principal for energy, Joe Consolo, thinks the idea is more than real. ESG requirements are increasing in scope and scrutiny. Those changes, says Consolo, require buildings to improve operations, technology and tenant behavior. He tells *PERE* what makes a building ESG obsolete and explains what owners and tenants can do to avoid this fate.

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Q What is the traditional model of obsolescence?

Traditionally, buildings become obsolete by losing market value, and part of the reason for that is they become outdated. People think about market value from the perspective of functionality, in either the design or amenities. Another factor could be the economics of the building, which could be driven by a location-related problem such as jobs moving out of the area.

However, what has come to the surface recently is 'ESG obsolescence.' This is a different category because it is about risk – the risk of non-compliance or the risk of losing value in a property because of its sustainability credentials.

Q Why has ESG obsolescence emerged?

One of the key drivers behind ESG obsolescence is investors. ESG compliance and energy efficiency are two new factors driving investment decisions. If the investor needs to put their capital into a property to bring it up to the standards now expected by modern compliance rules, it will

Q What are the key considerations involved in ESG obsolescence?

ESG has three elements. However, the environmental aspect is where the majority of people are focusing their attention today. This mostly relates to the energy consumption of a property. If you have high carbon emissions through energy usage, what are you doing to reduce that? Considerations will also be paid to the efficiency of the equipment in the property; you want it to be operating existing equipment at maximum efficiency or drive further investment in more efficient equipment.

The other element getting increasing attention is the social piece. It is increasingly prescient and centers on the well-being of the people using the building. Investors will be looking at whether a property has a healthcare facility or if the tenant runs any wellness programs, and at the overall impact of the building and company on the local community. In other words, what are you giving back to the community? Or, more simply, what are you doing for the people using the building and how are you offering them a healthier lifestyle?

reduce the asset's value to them and therefore reduce the price of the asset. In such cases, an investor may not even be interested in investing in the first place. They would have to put so much capital into bringing a building up to standard or reducing its energy consumption. This means there is less demand for the asset, which drops the overall value of the property.

Tenants have minimum expectations relating to building amenities and energy efficiency technology. Then there are the owners, who expect that the property will meet local environmental and construction laws. And if the building doesn't comply with those laws, there are often fines to pay. With these laws only becoming more stringent, there is a significant risk for the future if you barely meet those standards today.

It is also possible that some buildings are obsolete before they have even finished construction. Suppose you are not thinking about the materials used during the construction process, equipment efficiency or the right technology.

"Investors and developers are giving a lot more thought to the materials, and even the design, during the construction phase"

In that case, you could have a building that has had a significant negative impact on the environment before it has even begun to operate.

In an older building, one of the issues you can't solve is the embodied carbon. About 10 percent of a building's annual carbon emissions are produced during construction, which can never be recovered. Obsolescence risk is, therefore, mostly concerned with the running of the building, from when it starts up in the morning to closing it down when empty.

Q What are the first steps for owners and tenants to ease the risk of ESG obsolescence?

The low-hanging fruit is to develop sustainable business processes. Engaging tenants to practice sustainability could be as simple as recycling, for example, or a program to encourage people to switch off lights as they leave an area.

Then there are the operational practices of a building, such as the

daily start-up and close-down processes. This could also cover building preventative maintenance such as changing filters or ensuring that equipment failure is dealt with so that other equipment is not struggling to make up for it.

Another key action that can be taken is to monitor what the building is doing and how efficiently it is running. When it comes to ESG, everyone struggles to get whole-building data and aggregate it. Technology can be leveraged here to provide aggregated whole-building data and to use this data for operational efficiency. Real-time data gives you visibility over the energy consumption in your building, which then allows you to decide what to change to improve efficiencies. Even after that, you can see what those changes have done, which can prevent you from sliding back and help you make further improvements.

Q What are some of the more advanced methods of combatting ESG obsolescence?

After those first steps, it gets a little more difficult – that last 20 percent of efficiencies will always be more challenging. This would involve installing technology that can help you operate equipment more effectively or alert you when it is not operating efficiently. It could be as simple as detecting faults or smart devices that can control equipment centrally.

These days, tenants generally expect motion-sensor lights, low-flow water systems and centrally controlled thermostats. Investors take this further and want more efficient equipment such as air handling units, because nowadays they have a deeper understanding of the impact of the building on the environment.

Oftentimes, building managers use non-technology-based solutions to operate buildings. Many are unaware of where technology could be applied to maximize efficiency. Some sensors can be used to monitor equipment, along with the software to help manage it all. The software can manage the empty spaces in the building, turn off lights if they are left on by accident, or even set limits on how high or low tenants can adjust the thermostats in each area. For example, artificial intelligence could be used to maximize tenant comfort and energy efficiency. Typically, these two requirements were thought of as mutually exclusive.

Another strategy is to invest in green energy sources for your building. Today, many owners take advantage of carbon offsets. Still, with increasing ESG standards, this is not a good long-term strategy. You can meet carbon caps by installing solar on rooftops or some offsite solar over parking garages, where you can then generate green energy on site. Investing in those is the next level toward avoiding ESG obsolescence.

Q How are owners taking action to avoid ESG obsolescence during the construction phase?

At Yardi, we talk to a lot of building owners and operators. Some owners have been doing this for 10 years and already have a formula in place. Others are just getting started with their focus on embodied carbon. In both cases, building construction falls under an ESG program.

Investors and developers are giving a lot more thought to the materials, and even the design, during the construction phase. For example, if you can design a building that uses fewer materials, such as just-finished concrete, then you don't need to lay flooring or expose the ceilings, pipes and ducts in an industrial style. All this embodies less carbon from the start.

Q What is driving these changes?

There are asset managers who are focused on sustainability as part of their core values. Still, the majority are being driven by investors or regulations.

> *"Technology can be leveraged… to provide aggregated whole-building data and to use this data for operational efficiency"*

Then there are cases of tenants and employees that are driving change. We have seen examples in New York where energy scores are posted on the front of buildings to advertise their sustainability to potential tenants walking by – if all other factors are equal, but one building has an energy score of 80 percent and the other 90 percent, a tenant would likely choose the building with the score of 90 percent as their energy bill will be lower, and they feel good about helping the environment.

At the end of the day, ESG obsolescence is avoidable. There are always things you can do to avoid or cure ESG obsolescence. It starts with visibility, and ESG whole-building data aggregation will provide you that visibility. You have to set goals for your organization and understand how you are going to get there. The next step is to think about prioritizing what will have the biggest impact in the shortest timeframe. It is all about making progress toward your goals at a pace that keeps you ahead of the necessary changes. ■