PUTTING PEOPLE FIRST

By Lauren Krause
Director of Environment, Social, and Governance
Grosvenor Americas

Brian Biggs, CFA
Research Director
Grosvenor Americas

Though "impact investing" is no longer totally distinct from investing in general, investors still have a lot of work to do to fulfill the social and governance aspects of ESG expectations.

Gone are the days when investors considered "impact investing" separate from just "investing." In virtually every industry, environmental, social, and governance (ESG) matters have moved from a peripheral concern to a core business pillar. Real estate is no exception.

Within real estate, the conversation around the environmental component of ESG is quite advanced—and with good reason, as real estate is one of the largest domestic sources of greenhouse gas emissions[1] and embodied carbon[2] in the developed world. The "E" of ESG also has well-defined assessment metrics, key milestones for decarbonizing, and a robust certification marketplace for verifying a building's green credentials.

The social and governance (S&G) components, by contrast, have received comparatively little attention, until recently. The data landscape for these criteria is less mature and performance standards and key metrics are less widespread and less consistent, partly due to lack of high-quality data.

This article introduces a "stakeholder perspective" as a tool for real estate companies to use when assessing the most material ways in which their business interacts with S&G considerations. Due to the challenge of collecting data within S&G, companies can struggle with identifying how their business activities can address social and governance needs/issues most effectively. The aim of this article is to offer a different perspective from those prevalent in S&G discourse in order to advance thinking and practice in real estate. We contend that the stakeholder perspective is a useful framing device companies can use to ensure their S&G activities are material, high impact, and consistent.

S&G: TAKING A STAKEHOLDER PERSPECTIVE

The United Nations Principles for Responsible Investing ("UNPRI") in Real Estate outline the basis of S&G in ESG investing *(Exhibit 1)*.

EXHIBIT 1: SOCIAL AND GOVERNANCE COMPONENTS OF THE UNITED NATIONS PRINCIPLES FOR RESPONSIBLE INVESTMENT (UNPRI) FRAMEWORK

Source: United Nations

SOCIAL	GOVERNANCE
• Community development	• Anti-bribery and money laundering
• Health and safety	• Cybersecurity
• Human rights	• Data protection and privacy
• Inclusion and diversity	• Legal and regulatory fines
• Labor standards and working conditions	• ESG clauses in existing leases
• Social enterprise partnering	
• Stakeholder relations	
• Occupier amenities	
• Controversial tenants	

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At a high level, the key social aspects of S&G are ethics, equity, and social cohesion, whereas governance focuses on legal matters and compliance with regulation. The UNPRI framework focuses on embedding ESG into the investment process from due diligence to acquisition, as well as holding through to disposition.[3]

Rather than consider S&G from an operations- or initiative-based perspective, taking a stakeholder perspective highlights how broad S&G principles touch multiple stakeholders and provide a structured approach to desired impacts.

We will consider five core stake holder groups: (1) employees, (2) customers, (3) the local community, (4) contractors and suppliers, and (5) capital partners *(Exhibit 2)*

EXHIBIT 2: KEY STAKEHOLDER GROUPS FOR SOCIAL AND GOVERNANCE PRINCIPLES

Source: Grosvenor

1: EMPLOYEES

Quality employees, who demonstrate high productivity, creativity, and loyalty are a key component to a company's success. Hiring, retaining, and growing employees can be a competitive advantage for companies that view the employee-employer relationship holistically.

A growing percentage of employees cite a company's mission and/or values as a primary reason they choose to work or stay with a particular company.[4] Encouraging employee involvement in S&G efforts not only demonstrates a company's values to employees but empowers employees to be directly involved in S&G impacts.

For example, at Grosvenor Americas our internal voluntary ED&I groups are one of our most popular employee engagement initiatives, annually attracting more than one-third of our staff. In a recent internal survey, more staff commented on the ED&I groups' work than sent questions relating to post-COVID working preferences. Additionally, in an effort to state clearly and focus on our values, our annual review process explicitly considers and financially rewards ESG efforts.

2: CUSTOMERS

Customers, such as tenants or homebuyers, are responsible for transactions that facilitate real estate companies' operation and longevity. Leases incentivize repeat business and significant operating expense can be avoided by retaining tenants.

A growing body of research demonstrates the direct correlation between a building's characteristics and tenants' health.[5] Whether considering COVID-19 safety precautions, or the impacts of physical space on mental health, health and wellness impacts tenants' decision to occupy space. For instance, multiple high-profile tech companies have committed to only executing new leases in buildings that prioritize tenant health through certifications such as WELL and Fitwell. These market signals indicate that customers recognize the importance of occupying space that prioritizes tenant health and reduces risk by establishing standards surrounding business partners.

In response to these shifting trends, savvy real estate companies are responding by including commitments or goals surrounding S&G considerations. BentallGreenOak includes "healthy building" considerations, including water quality, air quality, healthy food options, fitness amenities, natural light, and biophilic features, in investment and asset management decision-making.[6] As office occupancies continue to rise with reducing COVID cases, one can expect the focus on healthy buildings to only increase.

3: LOCAL COMMUNITY

The local community comprises individuals, organizations, and companies who occupy physical space around a real estate company's area of business. Central to much of how UNPRI defines "S" is the encouragement of actions that support communities and the avoidance of activities that detract from or harm communities. Local communities are typically considered less significant to a company's performance than customers, though a company's actions often impact them. Thus, their inclusion in a stakeholder view of S&G is not only warranted, but also serves as an important reminder of the mutual relationship between communities and companies.

A company that adopts S&G as a focus will consider local community concerns and desires within its decision-making processes. As an example, Tishman Speyer and the San Francisco Giants have partnered with the Port of San Francisco on the redevelopment of Mission Rock, a major mixed-use project in San Francisco. In connection with the procurement of consulting and contracting services, the developer has promoted a series of innovative approaches to encourage hiring local, small, and/or minority-owned businesses.

The project has a 20% local business enterprise (LBE) participation goal for all project contracts, and 30% local workforce requirement, with 15% goal for disadvantaged workers. For example, during procurement the development team, general contractors, and subconsultants work closely to understand any business challenges that may make small businesses less competitive, such as upfront burdensome mobilization costs, higher insurance premiums, or less purchasing power, and work to remove those barriers. Contracting innovations include flexible payment contract structures, labor-sharing "service agreements" for sub-tier subcontracts, and mentorship arrangements between larger companies and LBE's.

4: CONTRACTORS AND SUPPLIERS

Supply chains are increasingly becoming a point of focus and understanding the stability, ethics, and practices of businesses that are integral to the operation of a company is both a risk and an opportunity.

By including contractors and suppliers, a company broadens the impact of their actions. Companies can advocate for S&G actions with downstream supply chain partners by openly discussing businesses practices and developing principles or rules that are incorporated into contracts or other binding agreements.

One example of this in real estate is Revo's Social Value Framework, where the company has included "Responsible Procurement" as a priority and has begun to measure the percentage of suppliers that adhere to specific supply chain considerations.[7]

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5: CAPITAL PARTNERS

Capital partners are organizations that act as part of a real estate asset's capital stack, either by owning a portion of the asset on a passive basis or as a lender. This group of S&G stakeholders is also known as "upstream" supply chain partners, in contrast to the "downstream" supplier chain partners (#4).

The process of soliciting capital partners and finding operators that align with a lender's or manager's goals is a two-way process. Assessing risk/return profiles, diversification strategies, and business practices is a critical part of developing a new investor/investee relationship. Operators that prioritize S&G standards demonstrate responsibility, risk avoidance, and innovation to capital markets.

Managers are tasked with growing the capital under their control in the most risk-adjusted manner possible. By understanding how an operator considers risks and opportunities surrounding S&G, managers can better assess and select operators. Additionally, some equity partners and lenders manage capital from individuals or groups who have internal ESG metrics. By aligning funds under management with an operator with similar perspectives, incentives are more likely to be similar.

In the real asset industry, GRESB was established in 2009 by a group of investors looking for a way to quantitatively assess operators' performance on ESG factors. As capital market's focus on ESG continues to expand, GRESB participation has increased, demonstrating the desire for quantitative ways to measure all aspects of ESG.

EXHIBIT 3: SOCIAL AND GOVERNANCE STAKEHOLDER GROUP IMPACT SUMMARY

Source: Grosvenor

STAKEHOLDER	WHY THEY MATTER	HOW THEY INTERACT WITH S&G	EXAMPLE
Employees	ESG focus is increasingly a competitive advantage to retaining high-quality and motivated staff.	Demonstrates a company's values to employees and empowers them to be directly involved in S&G initiatives.	A company pays employees for time spent on internal and external ESG initiatives, noted in annual review metrics.
Customers (e.g., tenants or buyers)	Responsible for transactions that facilitate operation and longevity for companies.	Avoiding reputational and operational risk of doing business with companies that do not focus on S&G.	The inclusion of "healthy building" considerations into investment and asset management decisions (e.g., water quality, air quality, healthy food options, fitness amenities, natural light, biophilic features).
Local Communities	Deeply impacted by a company's actions in the built environment.	A company that adopts S&G as a focus will consider local community concerns and desires within its decision-making processes.	A company formed a joint venture with a national sports team on a new development with set targets that encourage hiring local, small, and/or minority-owned businesses.
Contractors and Suppliers	Supply chains are increasingly becoming a point of focus as operators direct capital to high S&G suppliers.	Companies can advocate for S&G actions with downstream supply chain partners by transparently discussing business practices and developing principles incorporated into contracts and agreements.	A company's "social value framework" includes "Responsible Procurement" as a priority and has begun to measure the percentage of suppliers that adhere to these considerations.
Capital Partners	Operators that prioritize S&G targets demonstrate responsibility, risk avoidance, and innovation in capital markets.	Minimize reputational and financial risk through selecting high S&G operators; aligning investor and operator values.	GRESB, a set of international ESG standards, was established by investors in 2009 as a way to quantitatively assess operators' performance on ESG criteria and increasingly informs capital decisions.

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TAKING S&G TO THE NEXT LEVEL

By considering impacts on stakeholders and taking a "stakeholder perspective" in the development of its S&G goals, a company can align its actions with the areas in which it can have the greatest impact.

By focusing on who is impacted by S&G activities, as opposed to simply tracking what is being achieved, a stakeholder perspective offers several advantages to operators and investors:

1. **Clearer understanding of key stakeholders leads to better data collection:** With a clearer and more targeted definition of stakeholder groups, a company can collect better data on how best to serve stakeholder groups. Data comprises both quantitative (as is common in the environmental component of ESG) and qualitative (reflecting the fact that some S&G actions are better defined with traits or characteristics surrounding goals).
2. **Addressing S&G "blind spots:"** Without a structured way of thinking about stakeholder groups, even well-intended S&G activities might overlook a key stakeholder. By understanding and categorizing stakeholders in a structured manner, this perspective helps ensure that S&G impacts on all company stakeholders are considered. This includes primary impacts, targeting the stakeholder group in question, and secondary impacts, indirectly affecting stakeholder groups not targeted. In this way, the stakeholder perspective helps ensure companies have no blind spots in their S&G activities.
3. **Embedding S&G in day-to-day operations:** Companies interact with each of the stakeholder groups during day-to-day business operations. By centring stakeholders in S&G thinking, companies can move from having separate, discrete S&G initiatives to embedding S&G in the course of their everyday business operations.

The stakeholder perspective is a novel approach to a long-standing challenge in the ESG field: developing S&G goals that truly impact the groups a real estate company directly or indirectly influences. S&G topics are broad, and by centring stakeholders, this approach serves as a method companies may use to focus on meaningful and measurable actions.

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ABOUT THE AUTHORS

Lauren Krause is Director of Environment, Social, and Governance for Grosvenor Americas, responsible for leading sustainability, enhancing the existing focus of delivering social benefit, and chairing Grosvenor's Equity, Diversity, and Inclusion group. Brian Biggs, CFA, is Research Director for Grosvenor Americas, responsible for helping set Grosvenor's investment strategy, analyzing transactions, and advancing the firm's thought leadership projects.

NOTES

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