

SECOND-WAVE

sustainability



REDUCING CARBON EMISSIONS REMAINS KEY TO GREEN BUILDING, BUT SUSTAINABLE REAL ESTATE IS EVOLVING INTO A MORE COMPLEX BEAST.

AS THE WORLD COUNTS DOWN TO a goal of net carbon zero by 2050, the pressure is on to ensure environmental, social and governance (ESG) principles are front and centre of every business' strategic and operational planning, with real estate asset management top of that list.

The post-pandemic landscape has also fuelled a second wave of social sustainability that goes beyond carbon emissions to rate buildings - and companies - on everything from wellness and safety to diversity and climate resilience.

Bayleys national director commercial & industrial Ryan Johnson says while most large corporations are already prioritising

ESG issues in operational and strategic planning, as the regulatory landscape evolves, some of New Zealand's long tail of small-to-medium commercial property could be at risk of becoming stranded assets.

The World Green Building Council reports that 39 percent of global carbon emissions come from real estate, therefore, the sector has a big part to play in meeting the global target of Net Zero Emissions by 2050, to which New Zealand has committed.

In the New Zealand commercial market, Johnson says, owners of premium-grade buildings are highly engaged with ESG factors and proactive about implementing them.

"For a lot of larger institutions, the lead often comes from offshore. If you look at office buildings in New Zealand in some years close to 50 percent of them can be sold to offshore owners, typically to investors from the likes of the US and Europe where ESG is a standard part of operations.

"You can see the change in approach at an institutional level where ESG might once have been back on page 20 of the annual report, now it's right up at page two or three."

Knight Frank Asia Pacific director - strategic projects and ESG, Charlotte May agrees that ESG is front-of-mind for both investors and occupiers in the wider Asia-Pacific region. "Investors and multinational corporations are



"WHERE ESG MIGHT ONCE HAVE BEEN BACK ON PAGE 20 OF THE ANNUAL REPORT, NOW IT'S RIGHT UP AT PAGE TWO OR THREE."

RYAN JOHNSON, NATIONAL DIRECTOR COMMERCIAL & INDUSTRIAL, BAYLEYS

focusing on the overall performance of a building. They are looking for properties with operational, performance-based certifications, rather than just initial base build certifications," she says.



An August 2023 Knight Frank Bayleys (*YourSpace*) report for New Zealand found that 79 percent of companies surveyed made real estate decisions based on ESG strategies. One hundred percent of Australian and New Zealand companies surveyed in the report placed employee wellbeing at number two in their top agenda items, followed in third place by talent retention.

Johnson says those figures are a positive indicator of a strong commitment from New Zealand companies to sustainability issues, as well as an understanding that sustainability is a nuanced strategic issue that impacts every aspect of the business.

Most owners understand there is a return on investment for implementing ESG strategies through higher rentals, but there is also an ESG or "green" premium in cap rates as well, he says.

"It also comes down to people and talent retention. ESG factors are very important to today's employees. That makes them very important to their employers and that makes them important to owners of the premises they occupy."

May says that when many multinationals are developing occupancy 'stay/go' strategies they will focus on total occupancy costs as part of their decision-making rather than simply rent. "A more sustainable building may attract a higher rental, but, over the term of the lease, the total operating costs may be similar or lower as the building is more efficient."

STRANDED ASSETS

Though higher prioritisation of ESG for many landlords has been driven by occupier demand, regulatory requirements are likely to soon play a part in New Zealand. A proposed change to the Building Act will make it mandatory for new and existing public, industrial and large-scale residential buildings to hold energy performance ratings. If the amendment is passed, changes are expected to be phased in from 2025.

Bayleys national director property management services Stuart Bent says that amendment could present a challenge for New Zealand's small-to-medium commercial building owners who would need to invest in effective metering systems and undergo regular assessment through organisations like NABERSNZ, which rates the energy performance of office buildings.

"There might be a pill to swallow in terms of getting to the position of being able to collect the data to get the energy rating, but it's one of those things that can be seen as harder than it is."

That is particularly true given the risk of ending up with a stranded asset, a building that has not kept up with carbon emission requirements and is unable to be occupied, Bent says.

The brighter light on the horizon for lower-grade commercial buildings could come from an increased understanding of embodied carbon. That is carbon produced through the manufacture and transportation of materials used in new builds, as well as the construction process.

When those emissions are taken into account, it could start to make retrofitting older commercial assets more viable from an ESG perspective, than building new, Bent says.

"Occupiers often default to new builds, but there's a small question mark around some of them as people talk more about embodied carbon," he says, adding that could become the impetus for conversations between occupiers and landlords about how they can work together to repurpose a building on its original footprint.

Johnson says this offers a good incentive for owners to refit their assets, with B, C and D-grade buildings representing about 75 percent of the New Zealand market.

"There is significant opportunity for those landlords and the sooner they face that, the less risk they face of obsolescence," he says.

Bent believes that where building and company owners might have been able to sidestep sustainability issues, whether for financial or political reasons, that will become more difficult if regulatory requirements are introduced.

He points to the Government's NABERSNZ initiative which requires its agencies to achieve a minimum NABERSNZ 4-star rating when establishing new leases and a minimum NABERSNZ 5-star rating for newly built office accommodation.

Many organisations are also putting ESG strategies at the centre of procurement processes, Bent says.

For company and building owners unsure how to navigate the different carbon rating frameworks and green accreditations, a good commercial property manager will help, he says.

"For the large corporates who take their ESG goals seriously, a good commercial property manager will help implement them, undertaking tasks like manual data collection around utility consumption. For other owners, we can take a more strategic approach, making them aware of what can be done so they don't get left behind.

A DEEPER SHADE OF GREEN

One organisation helping New Zealand landlords and occupiers navigate toward a low carbon, healthy built environment is Te Kaunihera Hanganga Tautaiiao | New Zealand Green Building Council (NZGBC).

The council has recently released its draft for an updated version of its Green Star rating system for New Zealand buildings. It is currently in consultation with industry on its recommendations.

Green Star was launched in New Zealand in 2007, based on an Australian framework. Since then more than 250 New Zealand projects have been given a Green Star rating between four and six stars.



"COMMERCIAL DEVELOPERS HAVE REALISED THEY SIMPLY HAVE TO GET ON BOARD. AT ONE TIME WE REGISTERED AN AVERAGE OF ABOUT 25 BUILDINGS A YEAR, BUT LAST YEAR WE REGISTERED MORE THAN 80."

SAM ARCHER, DIRECTOR OF MARKET TRANSFORMATION, NZGBC

NZGBC director of market transformation Sam Archer says the revised rating framework is about raising the benchmarks for sustainable building and ensuring the framework is aligned to New Zealand's social, regulatory and built environment.

While New Zealand is probably five to 10 years behind Australia, and 15 behind the UK in our engagement with ESG principles, it is catching up quite quickly, Archer says.

"Commercial developers have realised they simply have to get on board. At one time we registered an average of about 25 buildings a year, but last year we registered more than 80."

Those registrations are not just for commercial office buildings. Archer says one of the largest areas of growth in interest in Green Star has come from the industrial warehousing sector, while the government's Carbon Neutral Government

Programme, requiring new public sector builds over a certain value to be 5 Green Star-rated, means a number of new schools and hospitals are also registered.

Under the new framework, 5 Green Star-rated buildings will represent New Zealand excellence by being a high environmental performer that addresses social issues relevant to the building owner. Four Green Star buildings represent a best-practice environmental performer, while a 6 Green Star building will represent climate-positive world leadership.

"Six-star buildings will need to be net carbon zero, but in future so will five-star and then four-star," Archer says.

The comprehensive Green Star framework includes managing operation emissions with requirements like encouraging the removal of all fossil fuels from buildings, including gas boilers and even gas cookers in commercial kitchens. On the embodied emissions side of the ledger, the framework aims to cut emissions from the current BAU by 40 percent by 2030.

Bent says reducing reliance on fossil fuels is one of the biggest opportunities for businesses and commercial real estate owners to help meet New Zealand's net zero climate target.

"We're seeing more examples in the market of fossil fuels such as gas and diesel being replaced with all-electric systems within buildings."

Bayleys' asset management team is currently working with several clients through the EECA-supported (Energy Efficiency and Conservation Authority) Government Investment in Decarbonising Industry (GIDI) Fund, which supports energy efficiency, and the switch from fossil fuels to cleaner renewable energy sources across the commercial and industrial sectors.



"WE'RE SEEING MORE EXAMPLES IN THE MARKET OF FOSSIL FUELS SUCH AS GAS AND DIESEL BEING REPLACED WITH ALL-ELECTRIC SYSTEMS WITHIN BUILDINGS."

STUART BENT, NATIONAL DIRECTOR, BAYLEYS PROPERTY SERVICES



"TOOLS LIKE GREEN STAR CREATE A CONSISTENT LANGUAGE THAT BRINGS EVERY RELEVANT ORGANISATION TOGETHER WHILST KEEPING THE GUIDANCE GROUNDED IN PRACTICAL ACTION."

LISA HINDE, HEAD OF SUSTAINABILITY, PRECINCT PROPERTIES

A successful application reduces carbon emissions and improves energy efficiency, as well as financially supports building owners with their capital expenditure planning, Bent says.

Though a lot of registrations to Green Star are new builds, Archer says a number do come from owners who are gutting and retrofitting their assets. "Plus, we do have a version of Green Star called Green Star Performance which assesses the in-use performance of a building. Uptake for that has been slower but is growing."

Precinct head of sustainability Lisa Hinde, who is reviewing the NZGBC's proposed Green Star framework, says the programme helps organisations understand and adopt sustainable best practice in an accessible and cohesive way.

"Instead of each organisation reinventing the wheel as to what sustainability and ESG looks like for property, tools like Green Star create a consistent language that brings every relevant organisation together whilst keeping the guidance grounded in practical action."

For global investors Green Star offers a benchmark that is consistent with international best practice and allows them to be confident that "robust, quality-assured ratings are achieved".

"Without these standards developed by industry and shaped by current global decarbonisation efforts, there is little to no oversight on what a holistically sustainable asset is," Hinde says.

"We are seeing a growing appetite in the number of occupiers requesting these types of conscious spaces that are helping landlords and developers to embrace ESG and sustainability standards as a minimum requirement.



"We are also seeing key prescriptive elements in the green bond market requiring a commitment to achieving minimum sustainability attributes, for example, minimum NABERSNZ ratings and Green Star in development and/or operation. That market is growing exponentially as financial institutions are being driven by their own green investment targets."

SOCIAL SUSTAINABILITY

While Archer says Green Star has a "laser focus" on carbon, it also focuses on social sustainability.

"A lot of people think of sustainability in terms of environmental measures, such as reducing carbon emissions and the environmental impact of materials, but there are a lot of social sustainability factors involved."

Those include social issues like modern slavery, he says. "It's things like making sure that within your supply chain you are not sourcing products and materials that might be using child labour.



"SOCIAL SUSTAINABILITY IS THE SECOND WAVE OF SUSTAINABILITY AND THAT'S REALLY ABOUT ENHANCING."

HAYLEY KOERBIN, GLOBAL SUSTAINABILITY DIRECTOR, NDY

It's about making sure labour practices for construction staff are up to standard."

NDY global sustainability director Hayley Koerbin, a member of the Green Star Expert Panel - Health and Wellbeing says post-pandemic tenant demand for better and healthier buildings is increasing.

"The health of our buildings has been thrust into the spotlight, Green Star sets minimum standards and higher performance benchmarks for elements such as fresh air, adequate light, reduced exposure to toxins, acoustic comfort, connection to nature and provision of amenity spaces.

"Building owners will see value through increased leasing velocity, attraction and retention of high-quality tenants, ability to increase rent and demonstrate industry leadership."

Koerbin says the importance of including health and wellbeing in ESG thinking is a simple equation.

"About 90 percent of an organisation's outgoings is what it pays staff; if we can provide buildings that support increased productivity and make people feel healthier, organisations will get a much better return on that 90 percent as absenteeism and presenteeism reduces."

She adds that wellbeing measures are positive aspects of sustainability that are more tangible and visible to tenants and their employees. "They have a direct impact on their day-to-day lives. Environmental sustainability also benefits all of us as humans, but it's a bigger picture that's sometimes harder to visualise.

"Environmental sustainability was the first wave, which was about protecting and minimising. Social sustainability is the second wave of sustainability and that's really about enhancing."



Precinct Properties' 6 Green Star-rated 10 Madden Street, Wynyard Quarter. Photo credit: Jono Parker