



# EMBEDDING ESG

## ESG FACTORS ARE A KEY CONSIDERATION ACROSS SECTORS IN THE COMMERCIAL PROPERTY WORLD TODAY, IMPACTING LENDING, ACQUISITIONS, GOVERNANCE AND SOCIAL RESPONSIBILITY.

GIVEN CLIMATE CHANGE NARRATIVES, more complex environmental risk due diligence being undertaken by purchasers, higher sustainability requirements by financiers, and growing social responsibility, commercial real estate is undergoing some significant shifts.

The pillars of environmental, social and governance (ESG) are now playing a huge role in the broader sector as the low emissions economy takes hold and the dial shifts on corporate and private accountability.

Bayleys national director commercial and industrial Ryan Johnson says the sector as a whole is being challenged to

“step up and wise up” on ESG as it builds momentum globally.

“Fundamentally, building owners must extend their identification of operational risk to ESG-related factors to secure finance and to ensure an asset remains fit-for-purpose with its future capital value protected,” he says.

“As an organisation, Bayleys is striving to do better on ESG throughout our business and proactively upskilling and looking for ways that we can add value for our clients.

“Sustainability performance, disclosure and reporting will play a much bigger part in the commercial real estate

sector and it’s a case of ‘when we know better, we do better.’”

### CENTRE FOR SUSTAINABLE FINANCE

The Centre for Sustainable Finance: Toitū Tahua is an independently governed charitable trust set up in 2021 to accelerate progress toward an equitable, inclusive and sustainable financial system.

Established by major financial institutions, Crown entities and strategic philanthropists, with support from The Aotearoa Circle, the Centre follows a global model used in the UK, Canada, Europe, Australia and Singapore.

Chief executive Jo Kelly says using the Sustainable Finance Forum’s 2030

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JO KELLY, CEO, CENTRE FOR SUSTAINABLE FINANCE: TOITŪ TAHUA

Roadmap for Action as an anchor point, the Centre sits at the nexus of finance and sustainability by connecting, collaborating, enabling cross-sector projects and tracking progress towards the roadmap’s goals.

Kelly acknowledges there is no “one size fits all” for organisations and businesses making sustainability commitments, and actions speak louder than words.

“Organisations should make sustainability commitments that are relevant and meaningful to them; however, if climate and human rights aren’t on their list, they may need to rethink their priorities.

“Generally speaking, organisations that understand and face the ESG risks associated with their business are better prepared to manage and mitigate those risks when they materialise, which they will.

“In reality, some businesses just won’t make it through the transition to a low emissions economy, regardless of how well they understand climate risk.”

Kelly says when looking to finance, providers of capital want demonstrable and credible long-term plans that position a business to be resilient, cost-effective and competitive in a low emissions economy and, for most, it will require a fundamental re-think of current business models, products and services.

“Organisations and businesses wanting finance should talk with their bank’s sustainable finance team, and be prepared to discuss their sustainability strategies and targets, drivers for change and any actions already taken to improve sustainability performance.”

In addition to voluntary international commitments, this year around 200 entities in New Zealand will be required by law to start producing climate-related financial disclosures which include scope 1, 2 and 3 emissions across value chains and what are referred to as “financed emissions”.

“This means many small businesses, including those borrowing from banks or suppliers to listed companies caught by this new legislation, will also need to put climate reporting in place, be planning to reduce their emissions and understand their risks in other areas, for example water use and biodiversity,” explains Kelly.

“I’d encourage all New Zealand business leaders to read the disclosure guidance we have published in partnership with Deloitte and the Sustainable Business Council, available on our website.”

For sustainability to be hard-wired into the business and financial arena, attitudes, processes and systems need to be upgraded with clarity required from government on its policy and investment priorities, according to Kelly.

“We know there is an increasingly high cost of inaction on climate and the scales are tipping quickly in favour of organised transition and adaptation.

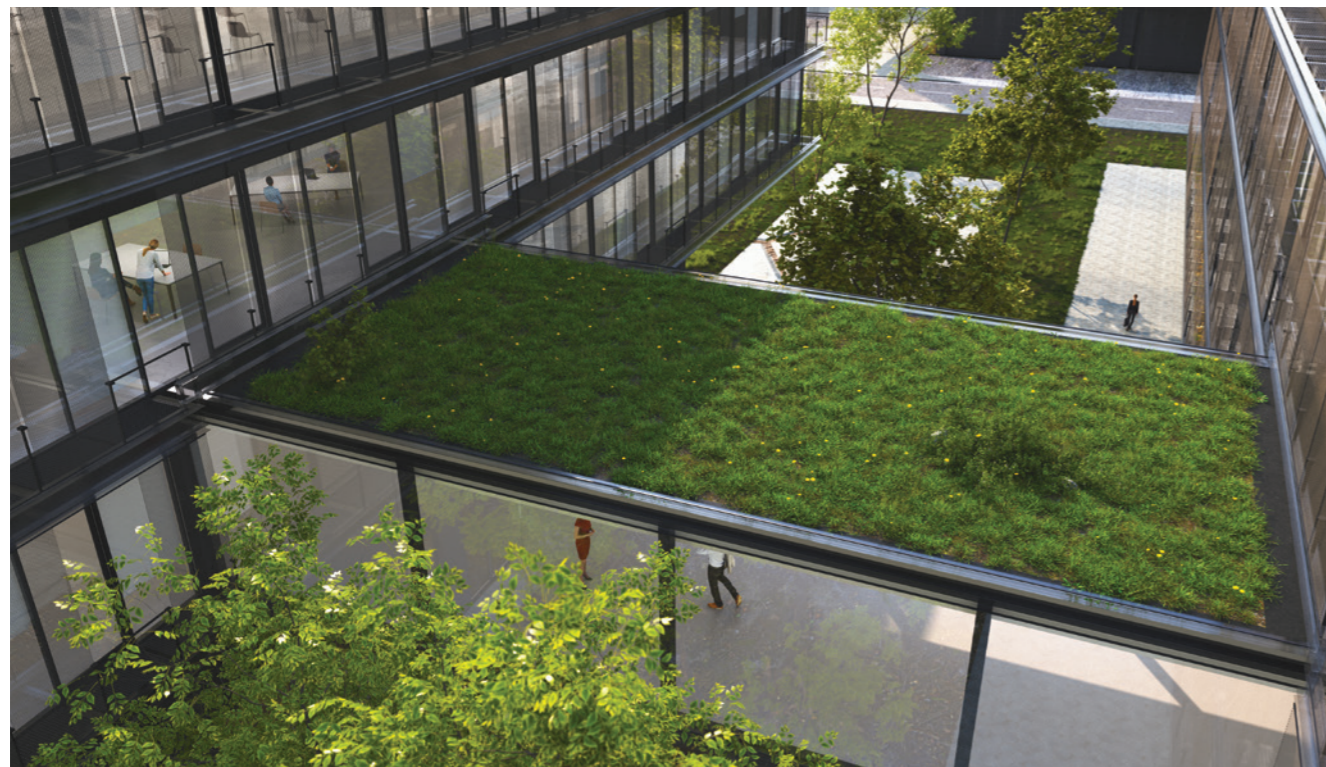
“The Centre has been working with government to determine whether New Zealand needs to codify definitions of sustainable economic activity into a set of definitions that can be used for investment decision making.

“Prioritised areas of investment have recently been highlighted by the Climate Change Commission in their advice to government and the Centre has also recommended the government develop a coordinated sustainable finance strategy.”

The New Zealand Green Building Council recently released its updated guidance for financing green buildings, with Dean Spicer, head of sustainable finance for ANZ saying it provides clarity to building developers, owners, occupiers and is aligned to global best-practice green financing.

For more information see: [sustainablefinance.nz/](https://sustainablefinance.nz/) [nzgbc.org.nz/green-finance](https://nzgbc.org.nz/green-finance)





## BANK TALK

Banks are challenged with embedding climate risk into the different stages of the credit lifecycle and aligning lending and investment portfolios with pathways to net zero by 2050.

BNZ general manager property finance Phil Bennett says banks have always factored ESG into commercial lending requests, especially governance which is strongly linked to character and capability (which, with collateral, forms credit's three Cs).

"From a tenants' and developers' perspective, the 'E' is becoming much more relevant, while from a funding perspective, they are all equally important so banks are definitely looking for documented and measurable strategies around the entire ESG framework – not just reducing outputs."

Under scrutiny are 'E' considerations like land development impacts, in-depth analysis of resource consent approvals, reduction of carbon footprint in new-builds and upgrades, and exiting poor quality assets.

"On governance and social criteria, we'll be considering ownership structures, succession planning, community benefits, and the quality of strategic plans.

"Also relevant are an applicant's employment relations and compliance history, internal reporting systems, and, where a board is in place, who the key decision makers/advisors are, and whether there is skilled independent representation."

## "BANKS ARE DEFINITELY LOOKING FOR DOCUMENTED AND MEASURABLE STRATEGIES AROUND THE ENTIRE ESG FRAMEWORK – NOT JUST REDUCING OUTPUTS."

PHIL BENNETT, GENERAL MANAGER PROPERTY FINANCE BNZ

Bennett says as ESG priorities are further embedded across the sector, commercial property developers, investors and tenants will all be impacted.

"Legislation will increasingly impose additional compliance requirements, poor quality buildings will be further discounted in the market, and leases that reflect occupier ESG policies with specific 'out' clauses if agreed building performance criteria aren't met by a landlord will become more prevalent."

Sustainability-linked loans, primarily for premium A-grade commercial buildings, are on the rise with BNZ as it "greens up" its lending books and Bennett says it's seeing 5-6 Green Star ratings being actively pursued, along with more owners committing to energy and carbon-efficient building upgrades.

"Additionally, we're seeing a small but increasing number of social or low-cost housing developments, including several with Iwi connections but while the affordable housing sector has definite growth potential, it usually requires

a high level of equity and often central or local government income support to adequately service debt."

Bennett said commercial property owners have a lot to think about when looking at a building's long-term market appeal.

"If the fundamentals are not addressed, and as the flight-to-quality continues, buildings could become obsolete and less desirable for some key segments of tenants.

"Owners must consider what needs to happen to the property to maintain or improve tenant desirability and allow rental rates to increase, what will this cost, how long will it take and how will these costs be met – equity or funding?"

## RESPONSIBLE BUSINESS

ASX-listed Centuria Capital Limited views sustainability as a lever to delivering strong business outcomes, while recognising that the fast-moving green train means best practice today, will be "business as usual" tomorrow.

Centuria's general manager sustainability Clint Wilson says investors, tenants and the wider community increasingly recognise the value that well-executed sustainability practices can have on real estate, and ESG is being broadly distilled throughout Centuria's internal business operations.

"Sustainability is just good business, and helps us attract capital, retain tenant customers and support the communities we work in.

"The sustainability universe is extensive and we can't prioritise all initiatives, so we collaboratively work with our various

stakeholders to focus on sustainability practices which deliver measurable outcomes and add value.

"Centuria can't tackle these factors alone, so it's critical to partner with the right industry organisations and stakeholders to collaboratively shift the dial.

"Industry bodies like the New Zealand Green Building Council and frameworks such as the Task Force on Climate-Related Financial Disclosures are rich resources we draw upon to demonstrate best practice."

Wilson acknowledges that it's often difficult to get initial momentum due to balancing various stakeholder involvement, but the outcomes are worth it.

"We recently worked in partnership with our tenant customer, Hancocks, at our 78 Tidal Road property in Mangere, Auckland.

"Hancocks has a passion for sustainability and we supported them with the installation of 480 rooftop solar panels, which now supply around 60 percent of the property's energy requirements, while a vegetable garden was planted for employees, adding to Hancock's ESG credentials."

Centuria takes a holistic and long-term view of an asset's worthiness, with older buildings judiciously assessed.

"Regardless of whether we hold or divest an older asset, it still stays within the community, leaving a legacy," explains Wilson.

"Considering the objectives of our investors, we focus on realising the potential these older assets have through an active management approach, which taps into their value.

"We use measures such as NABERS ratings to understand what opportunities there are to improve these assets' sustainability credentials, which we believe helps increase their value over time as well."

## CHANGING RETAIL NARRATIVES

Bayleys Property Services (BPS) national portfolio manager Michael Gillon has completed study through the University of Cambridge's Institute for Sustainability Leadership programme to better assist clients with ESG matters.

He's seeing growing awareness and tangible evidence of ESG action across the retail sector, largely driven by bigger corporate retailers, but increasingly across all business types.

Global corporate retailers will soon be insisting that premises they occupy have a sustainability component in line with company ESG goals, and green leases are gaining more traction, particularly for international tenants acting on stakeholder directives.

"Additionally, social and governance terms like the circular economy, modern slavery and traceable supply chains are becoming embedded in operational models as business owners respond to changing expectations," says Gillon.

Modern slavery legislation is ahead for New Zealand to address worker exploitation and labour force vulnerabilities, and Gillon says he's already seen proactive moves within the retail sector.

"When engaging cleaning contractors for example, attention is being given to the number of working hours, whether living wage rates are paid and what travel miles are involved to ensure health and well-being and legislative factors are not being compromised."

On the environmental front, Gillon says flagship apparel retailers like Icebreaker and H&M are taking a lead on the problem of fashion waste in landfill and providing textile bins in-store for customers to deposit unwanted clothing which is then sent to recycling plants.

With data showing one in four New Zealanders has an impairment or accessibility need, Gillon says some shopping centres and large-format

retailers are following global examples and better acknowledging diversity and inclusivity in the retail experience, thereby enhancing social sustainability.

"In Auckland, BPS is engaging with Be. Lab, an organisation which supports businesses and communities to become fully accessible, and looking at ways that properties under our property management programmes could better align with these goals.

"Some centres have introduced dedicated low-sensory shopping slots for the neurodiverse or those with accessibility difficulties, with security and customer service staff being educated to recognise customer needs.

"Globally, we're seeing the traditional shopping centre model being revolutionised and transformed through social initiatives.

"An example is Ingka Centres (IKEA) which is leading the way on social sustainability with its global Livat meeting places initiative, creating spaces within its retail environments where communities can meet, eat, spend time and experience new things, along with programmes to support the elderly and lonely."

For more information see: [www.belab.co.nz](http://www.belab.co.nz)

## "THE CIRCULAR ECONOMY, MODERN SLAVERY AND TRACEABLE SUPPLY CHAINS ARE BECOMING EMBEDDED IN OPERATIONAL MODELS AS BUSINESS OWNERS RESPOND TO CHANGING EXPECTATIONS."

MICHAEL GILLON, NATIONAL PORTFOLIO MANAGER, BAYLEYS PROPERTY SERVICES

