



#### **DEAR READERS**

In our most recent Insights into Real Estate Investment Sustainability (IRIS) survey we have seen responses that cover \$3.3tn AUM, which is one-third of the professionally managed global real estate market. An increase from \$2tn in our first IRIS 2021 survey.

The IRIS Survey has found that the market leaders have embedded ESG more deeply across the investment lifecycle, and the rest of the market is following.

We have seen the market mature, particularly amongst firms with \$5bn-\$20bn AUM who appear to have followed the lead set last year by the largest investors with over \$20bn AUM. However, firms are more cautious this year about classing themselves as 'Market Leading'.

In 2022, there is more ESG representation on Investment Committees and more ESG-linked incentives. We have seen more consistent capacity building across all scales of investment, with ESG training programmes in 76% of investment firms.

All of these results in IRIS 2022 point to a solid foundation for ESG integration into investment decision-making as we enter a markedly different economic environment. A period of reduced liquidity could force investors to hold riskier assets for longer.

ESG risks to income are seen as a key factor in investment value, alongside ESG reputational risks. This is driving deeper ESG integration at all stages of the investment lifecycle, particularly at the Investment Committee; during asset ownership/management; and at Board Governance. Amongst the larger investors, we've also seen more active integration in Investment Mandates; Deal Sourcing; and Asset Disposal.

Whilst we will see fewer deals transact in 2023, we should expect them to face a higher level of ESG risk scrutiny from institutional investors and larger investment managers. Smaller funds and family offices may lag a little further behind.

To future-proof asset value, green building design has emerged as a higher priority this year, moving ahead of sustainable property management and climate resilient locations. Although these latter two areas remain the highest priorities for the larger investors.

In summary, we have seen progress over the past year in the integration of ESG into real estate investment decision-making. The picture of what is 'market leading' is even clearer and this should indicate to all firms where they should be heading in the year ahead.

Sonny Masero

EVORA Global, Chief Strategy Officer

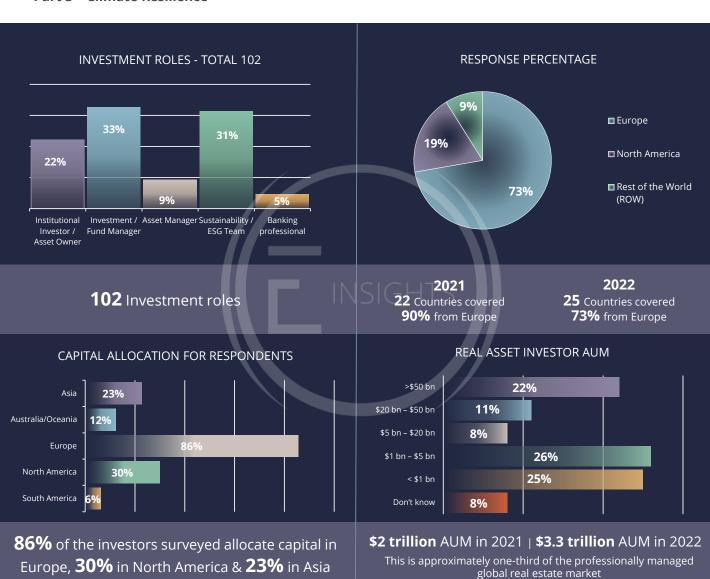
#### **INTRODUCTION**

In 2021, aligned with one of our strategic objectives – *to understand our clients and their markets better*, we launched **EVORA Insights**, a series of industry engagement events, reports, and thought leadership – to better understand the ESG evolution in real asset investment.

Our inaugural Insights into Real estate Investment Sustainability (IRIS) Survey in 2021 was well received in the market with investor responses representing \$2tn of real estate Assets Under Management (AUM). While the IRIS 2021 Survey was focused on European Investors, with the IRIS 2022 Survey we have been able to capture responses covering a wider geography, especially North America.

We will be releasing our survey results in three parts, with a final report covering all of the survey results

- Part 1 ESG Market Maturity
- Part 2 ESG Data Challenge
- Part 3 Climate Resilience



#### MARKET MATURITY





of respondents consider their approach market leading, compared to 41% in 2021



The inner circle shows the results of IRIS 2021 and the outer circle is from IRIS 2022

Comparing company approaches to ESG integration for 2021 and 2022 they are relatively similar but the "ESG Market Leader" percentage has dipped slightly from last year's survey. We believe that the ESG market is maturing, and investors have started to give serious consideration to ESG risk in investment decisions and are now more cautious of greenwashing. This is a result of clearer sustainable finance regulations and legal interpretation, as well as the increased likelihood of reputational damage and financial penalties following recent high-profile cases.

In the IRIS 2021 report, we elaborated on the ESG Market Leadership attributes i.e., it can be attained by:

- 1. Effective use of ESG Data
- 2. Accountability, and
- 3. ESG integration across the value chain and investment lifecycle.

In this report, we are tracking the changes in these aspects to gauge the market maturity and advancement from 2021.

Similar to IRIS 2021, large investors with AUM over \$20bn have shown a more advanced approach to ESG integration but in this report, we have also noticed an increased level of sophistication from investors with AUM over \$5bn. Thus, we are considering them as part of the large investor group in this report. This bifurcation is aligned with the UK's FCA's climate risk disclosure mandates i.e., investment/asset managers over \$5bn AUM will be subject to the new rules from January 2023.

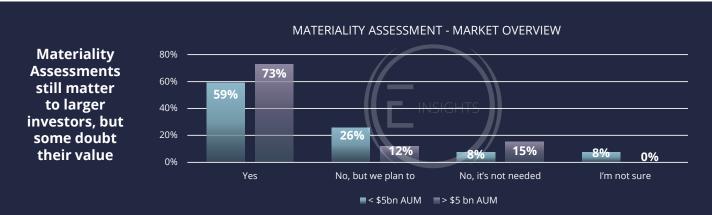
We have divided the report into three parts to assess market maturity:

- Creating a baseline understanding your investments
- 2. Policy and capacity building
- 3. ESG integration into the investment lifecycle.

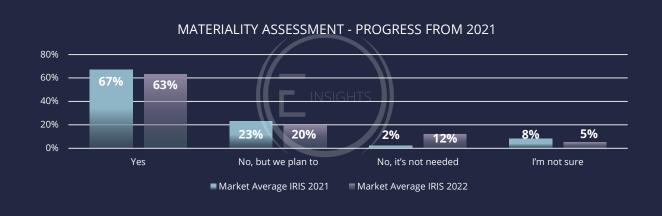
We hope this report will foster discussions and actions, and inform the future approach of ESG integration into investment decisions.



#### UNDERSTANDING YOUR INVESTMENTS



**73%** of the large investors with AUM over \$5bn have conducted materiality assessment as compared to **59%** of the smaller investors.





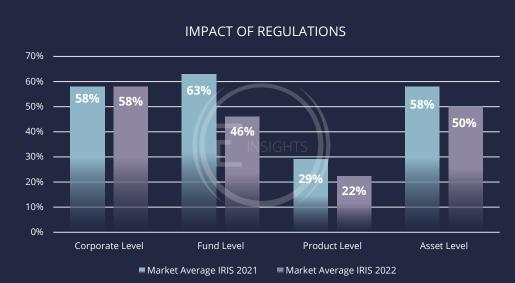
For investors with <\$20bn AUM, there is an average of ~20% who say that a materiality assessment is not needed. Overall, the findings in IRIS 2022 are similar to the findings in IRIS 2021 with the market average being in a similar range. The use of materiality assessments is correlated with investors' AUM but some of the investors do not consider materiality assessment to be relevant for their investment which is a bit concerning.

#### UNDERSTANDING YOUR INVESTMENTS



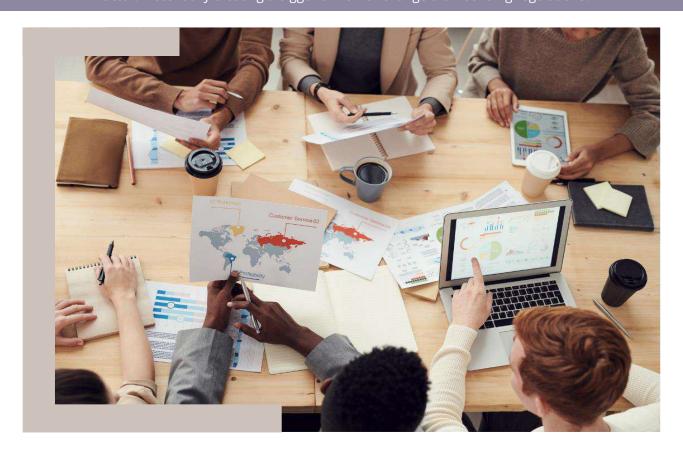


of the investors have witnessed the impact of regulations at more than one level as compared to 55% last year



Compared to IRIS 2021, investors in 2022 have reported a higher impact of regulation at the fund level, while the impact at the corporate and asset level are relatively similar.

The increasing amount of sustainable finance and disclosure regulations, like the EU SFDR, is a contributing factor. Potentially creating a bigger driver for change than building regulations.







## ESG REPRESENTATION IN INVESTMENT COMMITTEE (IC) – PROGRESS FROM 2021

More ESG Representation at Investment Committee



38%

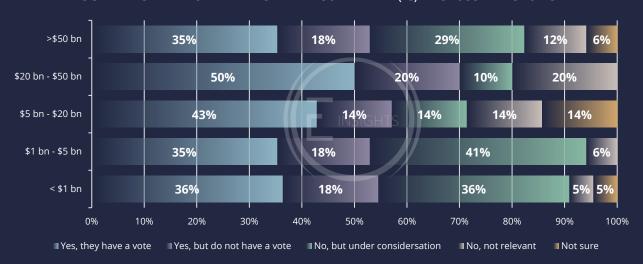
of ESG representatives have a vote in IC as compared to **24%** in 2021

representatives in IC with or without a vote has increased over **1.5x** in 2022.

10%

ef investors do not think that ESG representation at the IC is relevant, which is an increase on 2021, and this is higher in those firms with over \$5bn AUM.

#### ESG REPRESENTATION IN INVESTMENT COMMITTEE (IC) - ACROSS INVESTOR SIZE



Over **50%** 

of the investors across AUM bands have ESG representation in IC, which indicates that the market majority has started embedding an understanding of ESG risk investment decisions.

Similar to IRIS 2021, large investors with over \$5bn AUM are still a bit more advanced than smaller investors (under \$5bn) in ESG representation in IC.





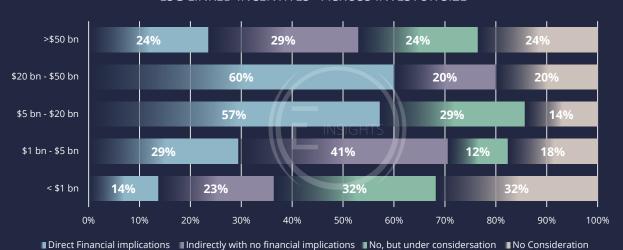




**55**%

of the investors now have ESG linked incentives (financial or non-financial), and this has increased since 2021. The smaller investors with AUM less than \$1bn are still planning to consider them.

#### ESG LINKED INCENTIVES - ACROSS INVESTOR SIZE



The overall results have improved in favour of ESG linked incentives. The bigger investors, particularly with AUM between \$5bn-\$50bn are leading the practice.



#### ESG TRAINING PROGRAMS

Building capacity at all scales of investment



There is not much variation from IRIS 2021 in terms of the market average for ESG training programs, but the consistency reported in IRIS 2022 across investor size is much better as compared to IRIS 2021. Along with the large investors, even the smaller investors with AUM under \$5bn are building capacity internally to assess ESG risks and their impact on their investments.



### DEEPER ESG INTEGRATION INTO INVESTMENT LIFECYCLE

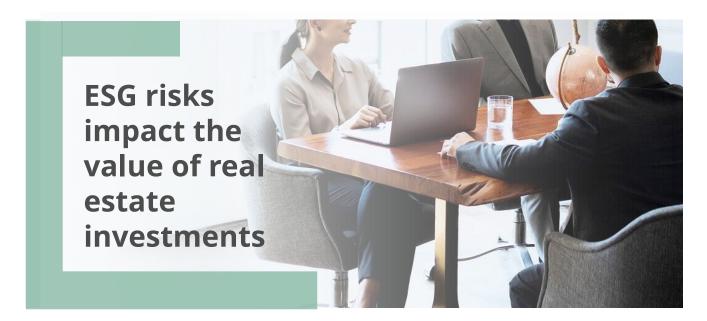


Reputational ESG risks and ESG risks to income does impact the value of real estate investments



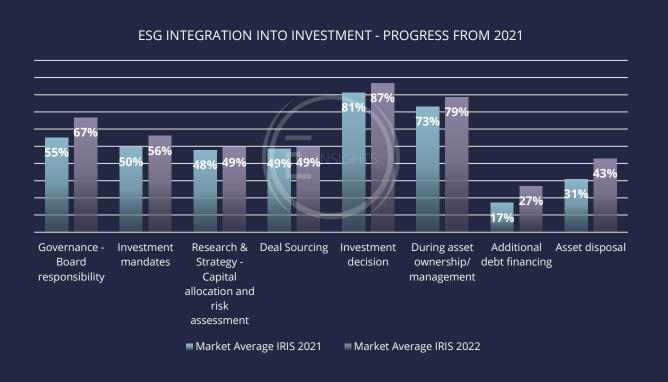
Similar to IRIS 2021 survey report, Reputational risk has emerged as the top risk factor to impact an investment value followed by other financial risks, particularly Leasing risk and Impact on Cash Flow.

Across investor size, the risk perception for each category is similar except for the Impact on Cash Flow. Large investors with AUM over \$5bn consider it to be one of the key risk factors closely after Reputational Risk. The recent energy crisis in Europe is one such example of the increase in operating costs which is impacting the cash flow for asset management.





#### **ESG INTEGRATION INTO INVESTMENT LIFECYCLE**



Key points in comparison from IRIS 2021 Survey report:

A positive increase across almost all stages is an indicator of the market maturing and accepting ESG integration into the investment lifecycle.

We have seen a significant increase at the asset disposal stage, as owners consider the disposal of risky assets, which is consistent with rising concerns about risky assets facing an inevitable downwards price correction and/or increased illiquidity.

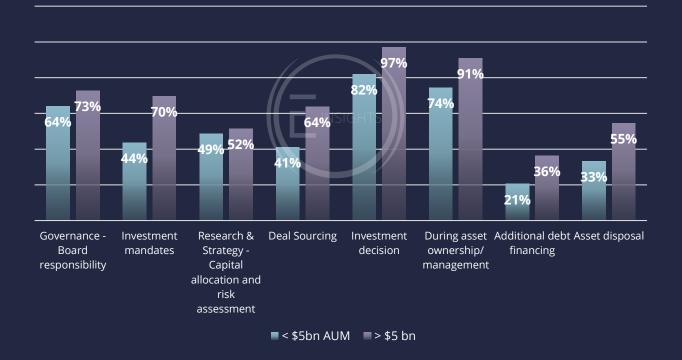
We have also seen a larger rise in Board Governance and ESG linked Debt Financing.

The discussion around asset price vs value is gaining more traction as the investor are evaluating forward-looking aspects rather than just the historic performance of an asset. Thus, pricing ESG risk into assets helps them assess their disposal approach.



#### **ESG INTEGRATION INTO INVESTMENT LIFECYCLE**

#### ESG INTEGRATION INTO INVESTMENT LIFECYCLE - MARKET OVERVIEW



Large investors with AUM over \$5bn AUM are more advanced in their approach to integrating ESG risks into their investment decisions.

The top three ESG integration points for large investors are:



These large investors are also significantly more active in integrating ESG into:



#### KEY TAKEAWAYS



For investment mandates, large investors are setting screening parameters for ESG risk which mitigates the ESG risk exposure and will steer capital towards climate resilient locations.

Large investors gather ESG data and conduct early due diligence at the research and strategy stage and deal screening stage to limit ESG risk exposure.

For asset management, large investors take the time to understand operational risks and the need for sustainable property management.

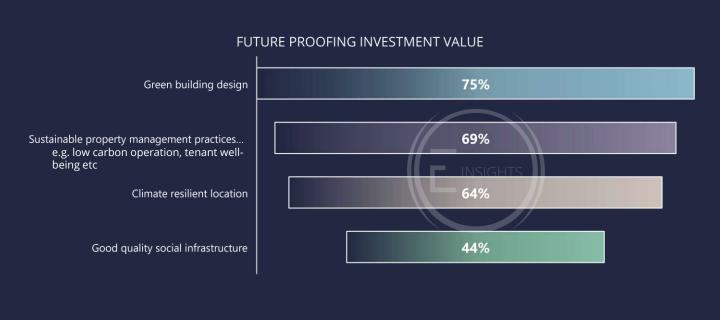
The focus on investment decisions is consistent with the finding on having an increased ESG representation on the IC and the use of ESG data at this stage.

Large investors are ahead in considering ESG risk disposal and therefore could be releasing riskier properties onto the market earlier before everyone else has priced the risk.

Large investors' approach to ESG integration across investment lifecycle, i.e. from investment mandates to disposal, will give them an edge over lagging investors with smaller AUM to futureproof their investment.



#### FUTURE-PROOFING INVESTMENT VALUE



The results suggest investors are prioritising green building design followed by property management practices to future-proof investment value. In the market, we have seen green buildings become synonymous with best-in-class property. Whilst sustainable property management practices emerged as a key factor in 2021 as well, the falling importance of climate-resilient locations is a bit surprising.

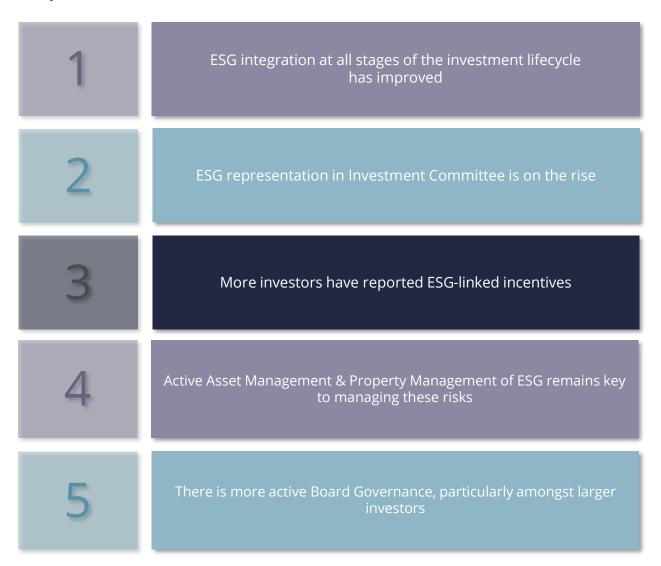
In contrast, it is worth noting that for large investors, with AUM over \$5bn, climate resilient location is the second top priority after Green Building Design. It can be inferred that large investors are focusing more on where they invest considering the climate risk exposure, vulnerability, and adaptability followed by prioritising the asset operations. That is consistent with the IRIS 2021 findings.



# INSIGHTS

#### CONCLUSION

Irrespective of investor size we are witnessing the wider and deeper adoption of market-leading ESG practices in the market. The largest investors usually have the resources and also face more scrutiny from the public and government which has resulted in an advanced ESG approach. The following five points indicate the progress in accountability and integration across the investment life cycle:



Larger investors have shown the direction of travel for ESG integration and smaller investors have followed this pathway over the last year. The leadership by large investors this year could be an indication of where the rest of the market will move to over the coming year, even in a more uncertain economic market.

In the next two reports, we will cover investors' views on the ESG Data Challenge and Climate Resilience.

