

EMBEDDING SUSTAINABILITY FACTORS INTO REAL ESTATE INVESTMENTS

A summary guide for pension trustees

Investing in real estate can offer pension funds long-term, contractual cash flows and potentially some protection against inflation. Geographical location and type of pension fund have a significant influence on the type of real estate investment opportunities available. This document sets out general approaches that can then be adapted for different locations and fund types.

Current landscape

Pension funds are increasingly diversifying their portfolios by investing in real estate. This is driven by a need for stable, long-term returns and inflation protection. Key observations include:

- **A notable trend towards sustainable and green real estate investments¹** – driven by growing recognition of climate risks and the impact of regulatory pressure to adopt net zero and nature restoration policies.
- **Changes in demand for different asset types** – a general downturn in transactions for offices but increases in logistics and data centres.²
- **A growing emphasis on properties that contribute to social impact** – such as affordable housing and community development projects. This approach seeks to maximize risk-adjusted financial returns while ensuring long-term societal and environmental benefits.

How are sustainability-related risks and opportunities influencing these trends?

Affecting growth in value – research clearly shows that sustainability-related factors can impact a real estate investment's long-term cash yield and growth in value.³ A broad range of factors can impact value, for example:

- Properties' social licence to operate can be affected or stopped by planners looking for community engagement and local support, or by lessees who are increasingly prioritizing the wellbeing of their workforce.
- Exposure to extreme weather events such as flooding and forest fires can significantly impact real estate, while sustained higher temperatures are likely to impact operational costs.
- Changing global trends and regulations aimed at reducing carbon emissions and promoting nature restoration may render some real estate obsolete.
- Factors such as resource degradation and energy cost fluctuations will impact the entire real estate investment cycle.

Meeting investment objectives – with 38% of global carbon emissions attributed to the built environment, upgrades to existing assets and new properties that support energy-efficient living and green urban development are increasingly desirable. For example:

- The potential for real estate projects to create jobs for underserved communities can help pension funds meet social impact objectives.
- Environmentally sustainable real estate can help pension funds to meet climate-related objectives and targets.
- Real estate assets often have land attributed to them that can be used to enhance biodiversity and help pension funds to meet nature-related restoration targets.

1. [2023 real estate assessment results \(GRESB\)](#)

2. [2024 emerging trends in real estate \(PWC\)](#)

3. [The future of real estate valuations: The impact of ESG \(RICS\)](#)

4. [Climate Change \(CIC\)](#)

Real estate investment and the net zero transition

Risks and opportunities	Key steps to address
<ul style="list-style-type: none"> • Risks may result from the regulatory trend towards enhancing energy efficiency through retrofitting. • New developments will be required to comply with stricter building standards. 	<ol style="list-style-type: none"> 1. Baseline – real estate managers must understand the impact of their portfolio to know where interventions are required. 2. Strategy – assets need to be rationalized and prioritized within portfolios: the bigger the impact, the bigger the risk. 3. Intervention – detailed, asset-level intervention plans are required to decarbonize buildings (see Figure 1).
<ul style="list-style-type: none"> • There will be opportunities in green lease premiums for more efficient buildings that reduce operating costs. • This in turn produces more desirable stock, leading to higher occupancy rates. 	

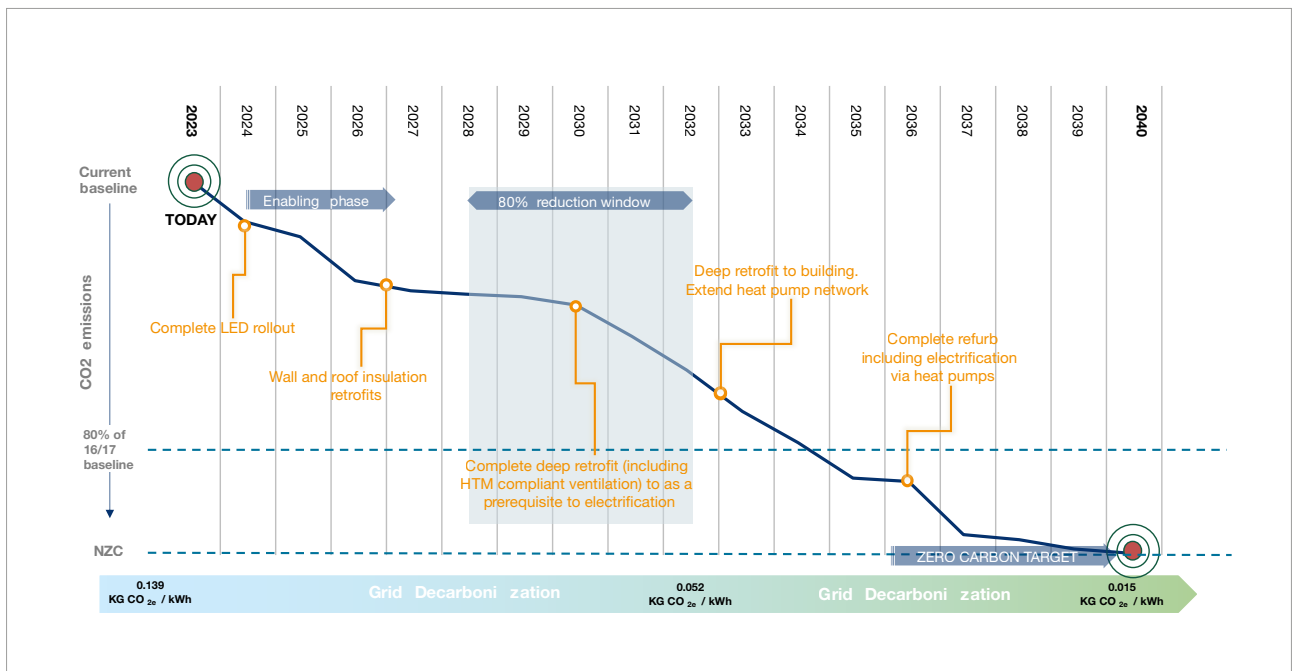


Figure 1: Example of an asset decarbonization plan (Source: [Terra Instinct](#))

Real estate investment and physical impacts of climate change

Risks and opportunities	Key steps to address
<ul style="list-style-type: none"> • Risk of extreme weather events occurring can lead to financially-material damage to assets. • Changes in temperature, precipitation, wind speed and other climate metrics interact with nature to exacerbate risks. 	<ol style="list-style-type: none"> 1. Assess – climate data from the Coupled Model Intercomparison Project 6 (CMIP 6) is readily available and can be used to assess location-specific climate risk (see Figure 2).
<ul style="list-style-type: none"> • Opportunities in mitigating climate risks can be strategically combined with decarbonization. Changing temperatures create a risk due to the increase in the use of heating and cooling systems. A key step in the decarbonization process is to reduce overall energy usage by introducing more efficient systems, and this has the added benefit of mitigating the risk. • Enhancing biodiversity around a site can reduce flood risk, lower temperatures and help to meet restoration targets. 	<ol style="list-style-type: none"> 2. Strategy – assets at greatest risk from climate events need to be identified and interventions designed to mitigate these risks. 3. Intervention – the strategy must be enacted over time as the risks develop, and financial products such as insurance should be used to offset shorter-term risks.

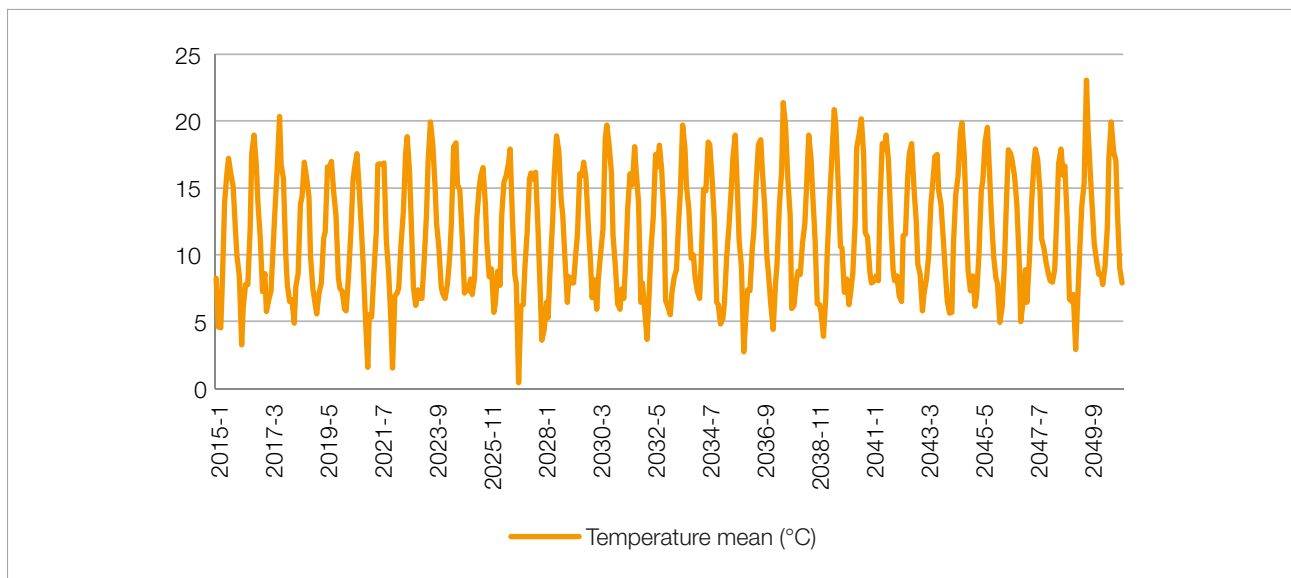


Figure 2: Location-specific temperature data from CMIP 6 (Source: [Terra Instinct](#))

Real estate investment and nature

Considerations	Key steps to address
<ul style="list-style-type: none"> • Risks associated with new sites are clear: they will inevitably damage nature and biodiversity during construction. • Existing sites with significant biodiversity value or located in biodiversity-sensitive areas are at risk of further regulation. • The Biodiversity Net Gain⁵ requirements in the UK and the EU Nature Restoration Law⁶ will likely lead to member states imposing stricter requirements in the future. 	<ol style="list-style-type: none"> 1. Baseline – remote sensing technology (such as machine learning and AI analysis of satellite data) can allow for baselining of vegetation at scale. 2. Strategy – identifying high-risk (nature loss) and high-opportunity (nature gain) assets and design interventions can mitigate the risk and exploit the opportunity. 3. Report – through the adoption of guidance such as that of the Taskforce on Nature-related Financial Disclosures and (if in scope) the European Sustainability Reporting Standard E4 – Biodiversity.
<ul style="list-style-type: none"> • Opportunities in the design phase for new sites can enhance their social value through better incorporating nature in design, reducing potential damage and offsetting costs. • Enhancing biodiversity on existing sites can lead to opportunities in new credit markets and make assets more attractive to lessees. 	

5. [Biodiversity net gain \(DEFRA\)](#)

6. [Nature Restoration Law \(European Commission\)](#)



Figure 3: Example of the remote sensing of a site (Source: Terra Instinct)

Sustainability Maturity Map for pension trustees

The A4S Sustainability Maturity Map for Pension Trustees, part of the [Sustainability Toolkit for Pension Chairs and Trustees](#), sets out examples of ways to integrate sustainability considerations into real estate investment decision making. Pension trustees at an earlier stage of this work might consider how to achieve

positive social and environmental impact by investing in sustainable real estate. For pension funds that are more advanced, trustees may be actively and publicly talking about the challenges and opportunities of sustainable investing in real estate investments.

Level 1 Understanding	Level 2 Adopting	Level 3 Deepening	Level 4 Leading
<p>The board:</p> <ul style="list-style-type: none"> • Incorporates decarbonization planning, climate risk and nature risk into asset manager due diligence prior to any allocations. • Can articulate the potential for financially material risks and opportunities arising from sustainability-related factors. • Actively engages with existing asset managers of real estate portfolios to develop a plan for baselining, developing strategy and costing interventions. 	<p>The board:</p> <ul style="list-style-type: none"> • Has oversight of baselining activity across the underlying portfolio for emissions, climate risk and nature risk post-allocation. • Identifies the assets with the greatest material transition and physical risks, to be prioritized for further analysis. • Ensures that asset managers and/or advisers regularly use scenario analysis, aligned with the most recent Intergovernmental Panel on Climate Change (IPCC) guidance and CMIP data. 	<p>The board:</p> <ul style="list-style-type: none"> • Has developed and costed intervention strategies covering material assets/topologies. • Puts in place scheduling of interventions for material assets/topologies so that plant and equipment are replaced at sensible times (ie at the end of their useful life) to minimize financial impact. • Ensures that the present value of these costs has been incorporated into calculations of yield and internal rate of return. 	<p>The board:</p> <ul style="list-style-type: none"> • Aggregates asset plans into a portfolio-level strategy that clearly articulates the costed impact for the entire portfolio of the transition to a sustainable economy. • Monitors a carbon budget to fund interventions, with clear reporting on their impact on yield and internal rate of return. • Has asset-level biodiversity restoration/enhancement plans in place. • Fully exploits funding strategies through credit sales and can articulate a portfolio-level biodiversity strategy.

Top tips for chairs and trustees

<p>Leverage expert knowledge across your service providers and civil society organizations so that trustees can understand the breadth of considerations</p>	<p>Such considerations could include:</p> <ul style="list-style-type: none"> • The potential for exposure to bribery and corruption scandals during the planning and construction phase. • The risks and opportunities associated with real estate construction, such as upskilling workers or being exposed to health and safety and labour rights abuses. • The long-term environmental impacts of buildings (including significant greenhouse gas emissions at the construction phase). • The role of carbon offsetting in achieving net zero real estate investments. • The use of buildings from a social perspective (ie whether tenants are treated fairly, whether space is earmarked for social tenants / socially focused businesses).
<p>Understand the current capabilities of your asset managers and plan accordingly</p>	<p>Key areas to test your asset managers' sustainability capabilities could be around:</p> <p>Climate</p> <ul style="list-style-type: none"> • A strategic approach to decarbonizing their portfolio that includes asset-level decarbonization plans. • An approach to setting a net zero target supported by a costed transition plan. • Use of IPCC and CMIP data in climate risk scenario analysis. • Developing costed mitigation and adaption plans for high-risk assets. <p>Nature</p> <ul style="list-style-type: none"> • An approach to baseline assessment that uses remote sensing technology or an ecological assessment on the ground. • A strategy for nature-based interventions.
<p>Ensure collecting and reporting on data is a central part of the process</p>	<p>This could include:</p> <ul style="list-style-type: none"> • Collecting data that enables metric calculation in accordance with leading frameworks (GRI, International Sustainability Standards Board (ISSB), European Sustainability Reporting Standards (ESRS), Taskforce on Nature-related Financial Disclosures (TNFD)). • That the portfolio reports into specific real estate initiatives such as GRESB and can explain the resulting scores.

This summary guide for pension trustees is part of a [Sustainability Toolkit for Pension Chairs and Trustees](#) by [Accounting for Sustainability](#) (A4S).

Acknowledgments

We would like to thank Harry Briggs and Jack Wardale from [Terra Instinct](#) for contributing to this document.