Sustainability funds in the real-estate industry – focus on Europe

The process of transformation of the finance industry shaped by sustainable investment aspects is gaining pace. There are two characteristics that define sustainable here: an investment approach based on management of finance products, and the property level, i.e. a focus on the lifecycle of the properties in the case of real estate.

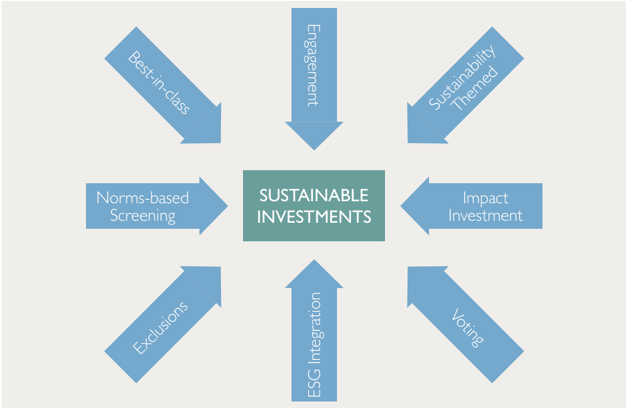
Through growing social awareness of eco-friendliness and responsible action, and driven by political conditions and objectives, sustainable investment has become increasingly prominent in recent years.

Sustainable management strategies – an overview

Management of these types of cross asset-class sustainability funds is usually based on the selection of specific criteria.
However, there is no uniform model or set of criteria here – but there is guidance that investors follow. The ESG criteria (environmental, social, governance) are increasingly being incorporated in the decision-making and analysis processes of companies. Within the sustainable investment market, there are various strategies, which are set out in Fig. 1.
Consistent growth has been observed in all strategies in recent years.
Essentially, there are three different methods:
– Exclusion criteria
– Best-in-class
– Standard-based screening.

The most widely used of these is the application of **exclusion criteria** with a volume of more than EUR 10 trillion in the entire sustainable investment market in Europe (+48 % from 2013 to 2015). Companies that infringe specific standards and therefore fail to meet the investor's value benchmarks are excluded here. Criteria such as breaches of human rights or the production of arms or tobacco can lead to an exclusion of this kind. This investment strategy contains sub-strategies such as divestment. In contrast with investment, this is specifically geared towards disinvestment in fossil fuels.

FIG. 1: INVESTMENT STRATEGIES



Source: Catella Research 2017

The **best-in-class** strategy is also very popular among investors: it refers to the targeted selection of companies that show above-average performance in a specific sector, with structurally positive criteria being taken into account (EUR 493 billion in Europe).

In **standard-based screening** (EUR 5 billion), companies are examined in terms of their compliance with certain international standards such as the OECD Guidelines for Multinational Enterprises or the UN Global Compact. Screening is also often used in combination with other strategies, and is particularly common in Scandinavia. By contrast, **sustainable thematic funds** enable investors to select a specific focus for their investment that is closely linked with sustainable development. The volume in this strategy totalled EUR 145 billion in Europe in 2015.

The **engagement approach**, which describes an active dialogue between investors and the management of a company, enables a personal basis. **Voting** is also carried out on a personal basis. It involves active exercising of voting rights at the annual general

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meetings of companies, allowing direct influence on corporate ESG policy. The strategy of **impact investing** is also gaining in popularity, and is aimed at achieving positive social effects by generating social and environmental benefits as well as financial returns. Finally, there is **integration of ESG criteria**, although this is often applied in combination with one of the above-mentioned strategies and tends to form the basis for a sustainable investment.

In general, though, it can be said that each company currently formulates the criteria in line with its own perceptions and focal points. Consequently, it is very hard to make comparisons between several levels, partly due to the lack of transparency and the various interpretations of the term "sustainability". Even so, the companies' respective focal points are reflected in ESG reporting.

Assessment by rating agencies

Financial products and funds are often launched in collaboration with various rating agencies that perform an assessment of sustainability management at the end. This forms the actual basis for possible investment decisions so that the investors, companies and customers can be given a high level of transparency (statements on success and risk). In the assessment process, the agencies use the above-mentioned strategies, which they usually use as a basis for final scoring.

In addition to company-internal analyses, another key factor in the assessment is the sustainability reports that the companies usually issue once a year. Nevertheless, sustainability reporting is still underdeveloped in internal and external reporting. As well as the statutory framework, the reasons are often the supposedly greater administrative workload involved and associated cost factors. Reporting is used in order to

- meet social expectations,
- carry out benchmarking and evaluation of in-house sustainability performance,
- enhance reputation, and
- support internal information and management processes.

At the same time, this framework forms the basis for what investors regard as the much more important benchmarking of the products and funds. With regard to real-estate products, the Global Real-Estate Sustainability Benchmark (GRESB), established in 2009, analyses the performance of real-estate companies, funds and portfolios. Nevertheless, as yet, there is no general benchmark that allows direct comparison of the products. Fund managers are usually measured according to their own set target yields and distribution ratios, and also compete internally with the conventional investment and real-estate funds. To date, the lack of a benchmark is due to factors including lack of reporting transparency on the part of the companies and the resultant low number of cases for products.

It therefore remains to be seen how a benchmark will develop in future. Incorporation of various indices would be one possibility here.

FIG. 2: SELECTION OF BENCHMARKING INITIATIVES (REAL ESTATE)

Global Real Estate Sustainability Benchmark (GRESB)
Green Rating Alliance
INREV European Association for Investors in Non-Listed Real Estate Vehicles
Greenprint Foundation
Carbon Disclosure Project

Source: Catella Research 2017

The sustainable investment market

The market is chiefly driven by institutional investors such as churches, pension funds and foundations, which is mainly reflected in the German market: around 90% of sustainable investments are made by institutional investors. Yet growing numbers of private investors are also turning to sustainable and responsible investments. In particular, Scandinavia and the Netherlands have a strong position in sustainable investment. Sustainable investments account for 61% of the total volume of all assets in the Nordics, while the proportion in Europe as a whole is "only" 37%.
Last year (as at 2 December 2016), a total of 101 new sustainability funds were launched in Europe, whereas there were only 96 funds in the previous year. The fund volume is also continuing to grow year by year – approx. EUR 6.5 billion was invested in the 101 new sustainability funds. Equity funds still make up the lion's share here (cf. Fig. 4).

Whereas assessment in this asset class is mainly based on the companies' philosophies (avoidance of critical sectors such as arms, tobacco, pornography and gambling), the criteria for real-estate funds are based on aspects such as location, tenants and buildings.

FIG. 3: VOLUME OF SUSTAINABLE INVESTMENT IN EUROPE

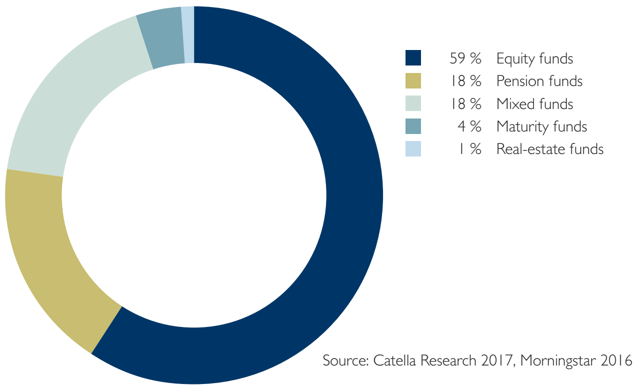
Countries	Volume of sustainable investment in EUR billion*
Belgium	315.9
Denmark	118.4
Germany	1,786.4
Finland	68.0
France	3,121.1
United Kingdom	1,555.3
Italy	616.2
Netherlands	991.4
Austria	52.2
Poland	6.0
Sweden	791.7
Switzerland	1,527.6
Spain	95.3
Europe in total (13)	11,045.5

* * Figures relate to 2015 in all asset classes

Source: Catella Research 2017, EUROSIF 2016

■ Very high market growth

FIG. 4: STRUCTURE OF SUSTAINABILITY FUNDS IN 2016



Source: Catella Research 2017, Morningstar 2016

Sustainable real-estate funds

As part of the transformation towards a sustainable investment approach of the real-estate industry, a considerable reduction in CO2 levels has been apparent in the last 10 years, especially in the European building sector. This is because of stricter minimum criteria both for new buildings and especially for renovation of existing properties.

It is also becoming clear that CO2 levels have emerged as an alternative measurement parameter for buildings.

The real-estate industry has been through three phases in this development:

1. Focus on building certificates
2. Minimum requirements in construction of buildings
3. Transformation in management of properties and raised awareness of user behaviour.

Sustainability certificates provide the opportunity for measurability and comparability here through compliance with the sustainability criteria in line with nationally established and internationally recognised certification systems, and also have a quality dimension that is reflected in aspects such as value stability. In addition, these are mainly used for new buildings in order to enable implementation of stricter requirements.

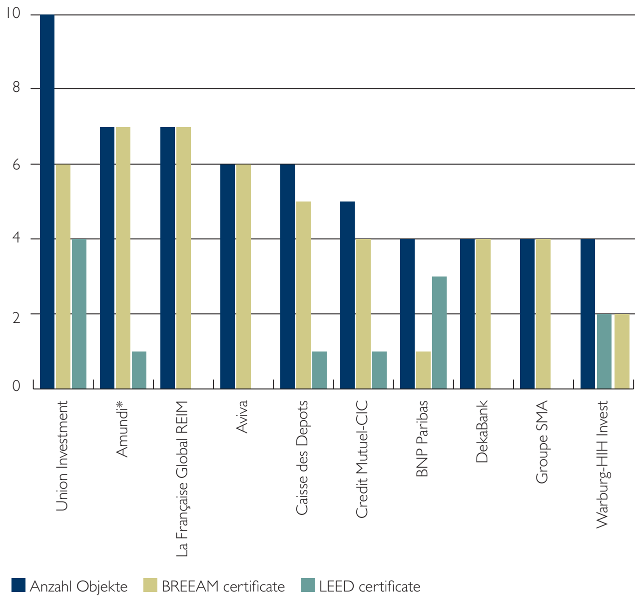
There are around 60 national certification systems worldwide – the best-known include BREEAM (USA), LEED (UK), DGNB (Germany), HQE (France) and Minergie (Switzerland). Yet sustainability is not confirmed by certificates alone. In the real-estate sector, it is necessary to meet user expectations (in terms of comfort, safety, health, etc.) and also to give due consideration to the environment. By contrast, with existing properties, there are no set targets that can be used for benchmarking. The sustainable process starts with purchase planning and comprises the entire lifecycle of a property (construction, re-purposing, etc.).

Office properties in particular do well in terms of sustainability management, followed by the retail and residential sectors. Even so, new initiatives such as the Well Building Standard show a further focus on the “inner workings” of buildings and users. The number of cases is still very low in Europe. In our view, this status is currently suitable only for corporate properties (headquarters). Table 1 shows a selection of active sustainable real-estate funds in Europe. At present, the fund volume of all real-estate funds managed explicitly in line with ESG criteria in Europe is around EUR 2,730 million. It is noticeable here that the geographical area is mainly limited to the DACH region – Switzerland in particular is proving to be a pioneer here. In Germany, real-estate funds account for 17% of all sustainable investment funds. Switzerland heads the list with 20%. By contrast, sustainable real-estate funds have only a share of 1.2% in Austria.

The first sustainability fund there was launched only last year (see Table 1).

In general, it is clear that the market for sustainable real-estate funds is still very much in its infancy. Even in Switzerland, the first sustainable real-estate fund was not launched until 2009.

FIG. 5: TOP 10 GREEN BUILDING INVESTORS IN EUROPE (SELECTION)



* One property has a BREEAM certificate and an LEED certificate

Source: Catella Research 2017, RCA
As at: 1 June 2017

Summary

The market for sustainable real-estate funds still has considerable untapped potential. Nevertheless, new sustainability funds are being launched each year, and the trend continues to gain momentum. Sustainability has now become a firm investment criterion in portfolio management.

Pension and equity products remain the most popular asset classes, with real estate also giving a very positive impression. Yet sustainable real-estate funds are scarce at international level in particular.

Transparency and binding standards also need to be significantly increased throughout the sustainable segment, on both the supply and the demand sides. In the key area of sustainability reporting in particular, the focus is on disclosing information on economic, environmental and social performance as well as management behaviour.

However, disclosure is just the second step of the reporting process. Prior to publication, companies must first determine, gather and measure information (sustainability auditing). This is where we envisage the greatest efforts being made by companies in the years ahead in order to trigger further impetus in what is still a straightforward market segment.

TABLE 1: SELECTION OF SUSTAINABLE REAL-ESTATE FUNDS IN EUROPE

FUND	COMPANY	INVESTMENT REGION	YEAR OF LAUNCH	TARGET VOLUME	FUND ASSETS (NET) IN EUR MILLION
CS Real Estate Fund Green Property*	Credit Suisse	Switzerland	2009	Keine Angabe	1,708.5 (31 December 2016)
SF Sustainable Property Fund	Swiss Finance and Property Investment AG	Switzerland	2010	Keine Angabe	368.7 (31 December 2016)
Sarasin Sustainable Properties – European Cities	Catella, Bank J. Safra Sarasin	Europe	2011	Keine Angabe	225.5 (31 May 2017)
ImmoWert	AXA Investment Managers Deutschland GmbH	Germany, Austria and Switzerland	2012	200 Mio. €	188.3 (30 June 2016)
Vontobel Sustainable Real Estate Europe**	Vescore, Vontobel, Quadoro Doric	Europe	2014	500 Mio. €	Not specified
Raiffeisen Futura Immo Fonds	VERIT Investment Management AG	Switzerland	2014	Keine Angabe	108.2 (31 May 2017)
Credit Suisse (Lux) European Climate Value Property Fund	Credit Suisse	Europe	2015	Ca. 1 Milliarde € (nach 5 Jahren)	Not specified
ERSTE Responsible Immobilienfonds	ERSTE Immobilien KAG	Austria	2016	Keine Angabe	99.9 (31 May 2017)
KCD-Catella Nachhaltigkeit Immobilien Deutschland	Catella Real Estate AG, Bank im Bistum Essen EG (BIB), Bank für Kirche und Diakonie eG (KD-Bank)	Germany	2017	260 Mio. €	32.0 (30 June 2017)

* Merged with Credit Suisse Real-Estate Fund PropertyPlus on 1 July 2016
** Formerly Vescore Sustainable Real Estate Europe and Notenstein Sustainable Real Estate Europe

Source: Catella Research 2017