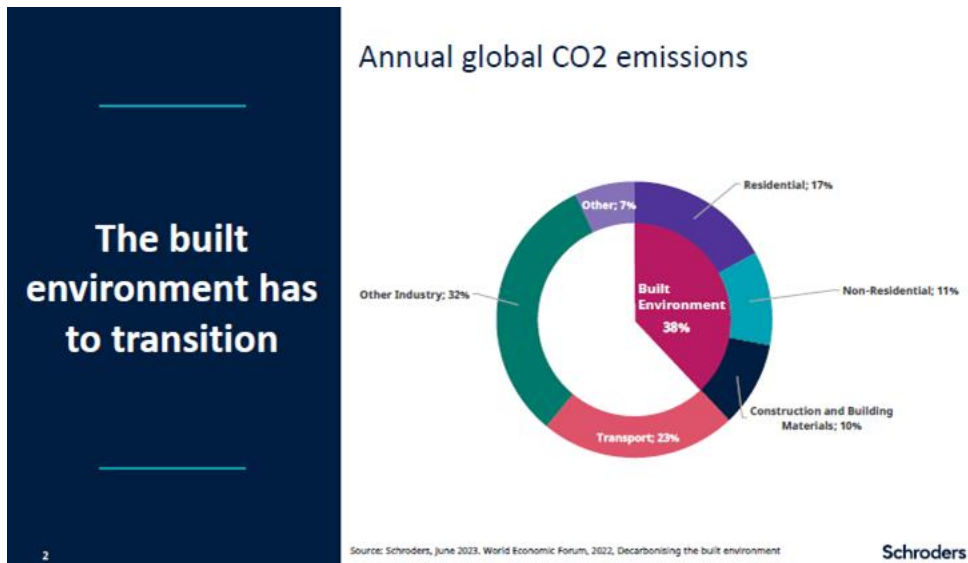


Build environment an emissions heavy hitter, but sustainable real estate holds transition potential and strong portfolio returns

Tom Walker, Co-Head of Global Listed Real Assets at Schroders

Tom Walker, Co-Head of Global Listed Real Assets at Schroders explores the virtuous cycle of sustainability and returns in real estate

The built environment is responsible for nearly 40% of global carbon emissions. That figure alone underscores real estate's central role in the climate agenda: it sits at the heart of both the crisis and the solution. Yet investing in sustainable real estate isn't just about doing good, it also holds the potential to deliver strong financial returns.



Understanding how sustainability translates into investment outcomes starts with evaluating emissions

Emissions are typically grouped into three categories. Scope One covers direct emissions - those from company-owned assets like heating systems and vehicles. Scope Two includes emissions from the electricity a business consumes, which varies depending on a region's energy mix.

Then there's Scope Three, the most challenging to measure, but often the most material. These emissions are generated through every source not owned or directly produced by the property. This includes workers' commutes to the property and any other emissions consumed and paid for directly by the building tenants.

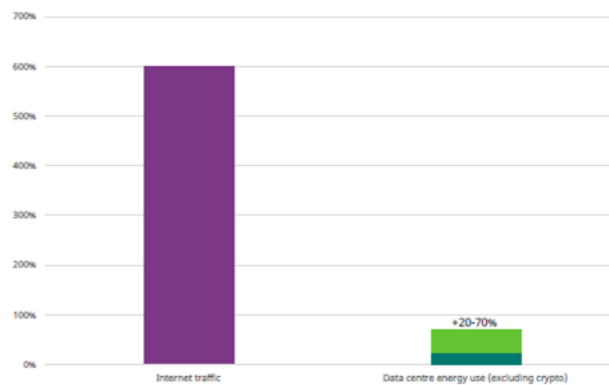
The distribution of these emissions can vary widely across property sectors. While some real estate subsectors like self-storage have low emission profiles, others - such as industrial and data centres - face intense energy demands. However, when managed with intention, even energy-intensive assets can become sustainability champions.

For data centres, energy intensity is a known challenge, but also a major opportunity

Operators that prioritise renewable power sourcing, efficient cooling, and heat recycling can dramatically reduce their operational emissions. Encouragingly, despite internet traffic increasing sevenfold between 2015 and 2022, global data centre energy use has grown only modestly in comparison. This exponential efficiency gain highlights how sustainability and innovation can go hand in hand.

Although demand has soared, data centres have become much more efficient

2015 – 2022 change



Source: IEA, July, 2023, [accessed on 20 February 2024], <https://www.iea.org/energy-system/buildings/data-centres-and-data-transmission-networks>

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Refurbishing a powerful decarbonisation tool

While most sustainability measures only capture operational emissions, building and decommissioning cannot be ignored. Embodied carbon – emissions from materials like concrete and steel used in construction – can make up a substantial portion of a building's lifetime footprint. This makes refurbishment a powerful tool. Reusing and retrofitting existing structures can be more environmentally effective than constructing new "green" buildings.

In Los Angeles, for instance, some industrial owners have opted to transform outdated warehouses into modern logistics hubs rather than rebuild from scratch. The resulting facilities now host tenants like major e-commerce and delivery brands, demonstrating how environmental goals and economic value creation can align.

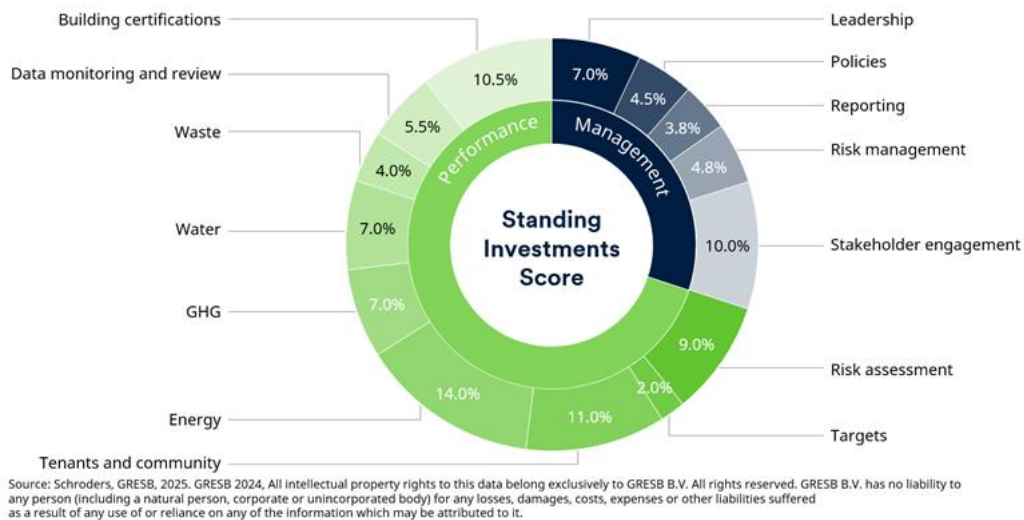
Importantly, sustainability in real estate isn't just about the environment. Social outcomes matter too. In Germany, as in many countries, there's a shortage of housing in urban areas. Instone, a German real estate developer, is leading the charge by integrating affordable housing into its portfolio, targeting 50% social housing by 2030. This addresses a growing need in urban centres while ensuring long-term demand and occupancy – demonstrating how social inclusion can support resilient investment strategies.

Better returns, lower regulatory risk and a win for the planet

Over and above helping people and the planet, there is growing evidence that sustainable buildings also deliver better investment returns. Research conducted by CBRE and JLL has found that sustainable properties tend to have higher occupancy rates, which translates into stronger rental income – typically 5% to 15% higher. This stronger cash flow in turn supports building valuations, which can be up to 20% higher compared to less sustainable properties. Operating costs are generally reduced – often more than 5% – due to greater energy and water efficiency.

Furthermore, sustainable buildings typically face lower regulatory risk. As increasingly more countries enforce energy-efficiency mandates, properties that lag will require expensive retrofits or risk obsolescence. By contrast, companies that invest early in sustainable practices not only contribute to global climate goals but also position themselves for superior long-term returns.

That said, it's important to take a holistic view when evaluating companies on their sustainability. At Schroders, we use data from the Global Real Estate Sustainability Benchmark (GRESB), which is widely considered to be the best sustainability data provider for the real estate industry and is used across both public and private markets worldwide. GRESB doesn't just look at emissions or energy use; it also considers how companies engage with tenants and communities, the governance policies they adopt, and how effectively they manage risk.



We then go a step further by assessing the sustainability of the locations themselves. As part of our Global Cities Strategy – with a database of over 220 000 mapped assets – we evaluate urban centres based on environmental resilience, public transport access, innovation, and economic vitality. People living in cities tend to consume less energy, rely more on public transport, and live in buildings that are more efficient per capita. All this feeds into the sustainability and ultimately the value of the assets.

This is the crux of what we believe is a virtuous cycle: sustainability supports stronger fundamentals, and stronger fundamentals support better returns. While there are many complexities and nuances, our experience shows that with the right data, frameworks and discipline, investors don't have to choose between impact and performance. In real estate, if done right, sustainability is no longer a constraint – it's a catalyst for value creation.