

REframing ESG

A new framework to refocus the approach to ESG in property and achieve outcomes

2024

How to simplify ESG in real estate and what wealthy individuals are doing in this space

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Critics argue that ESG criteria are overly broad or excessively influenced by ‘woke’ culture, which can lead to hesitancy or inaction. In this paper, we propose a novel, more focused approach to integrating ESG considerations specifically within real estate. Building on this starting point, we explore the findings of *The Wealth Report 2024*, delving into the behaviours and trends of affluent individuals whose investment choices and lifestyles significantly impact real estate markets.

EVERYTHING EVERYWHERE ALL AT ONCE

Both the title of 2023’s Best Movie Oscar winner, and a neat summary of the current state of ESG. “Broad enough to mean just about anything to anyone,” noted Hester Peirce, Commissioner on the US Securities and Exchange Commission, in a speech as far back as 2020.

The term, first coined in 2005 by the UN, was initially intended as a framework for measuring processes and outputs to drive transparency and accountability, ensuring we achieve equitable sustainability. But somewhere along the line it has got lost in translation.

Coming from the hottest year on record and entering what one research report describes as “*uncharted climate territory*”, the implications of this lack of focus have never been clearer. I have *previously written* about how at the same time the phrase has garnered all the wrong attention – being increasingly politicised, with some lawmakers in the US banning ESG as an investment screener and one of the early proponents, Larry Fink, stating he will no longer use the phrase.



So how can we get ESG back on track, and understand it is the idea we need to focus on rather than terminology?

We offer a new view for the property world – the “Five RE’s of ESG” – which are in no way prescriptive, or indeed mutually exclusive, but might allow for refocusing and simplification. Legislation and ESG

action boil down to fundamentally one or more of the five areas and regulation is often aimed at transparency to drive these. If these are measured and clear, then that helps drive Rational Sustainability, a new phrase described by London Business School Professor Alex Edmans (see page 8 for more).

Reality of ESG

Climate anxiety is on the rise. A stream of facts and numbers which paint a bleak picture set out a herculean task which can overwhelm. It is time to focus on what can be done through setting clear outcomes and this is what citizens are increasingly seeking.

“What can the nations of the world do to reduce global warming?” – asked by three-quarters of American’s in Yale University’s latest climate change and beliefs research.

Real estate has often found itself in a prominent position within the debate. With the built environment responsible for 40% of global emissions, a formidable effort will be required to reach net zero, but where do actors need to focus and what can they do?

That is the premise behind the new framework of the “Five RE’s of ESG” as an approach to incite action and serve as a reminder that we cannot do everything, everywhere all at once. As Edmans’ points out “A company is not responsible for addressing all of society’s challenges or pursuing all 17 Sustainable Development Goals,” there is a need for strategic focus on areas of comparative advantage and material significance within defined limits.

The Five RE’s are intended not to be mutually exclusive or exhaustive, but define outcomes to narrow the focus. They are to...

1. **REduce** consumption
2. **REnewable** energy generation
3. **REusing** resources
4. **REstore** nature
5. **REengage** stakeholders

Emission reduction is the common thread linking all five, but what do we mean by each element for the real estate sector?



1. **REducing consumption – most importantly energy use**

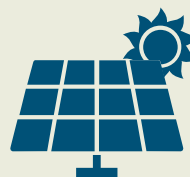
Reducing consumption, particularly in real estate, involves two main strategies: enhancing building efficiency and promoting material reuse. Our primary focus here is on the former, recognising its potential to decrease emissions, cut operational costs, and facilitate the integration of future technologies like electric vehicles (EVs) and comprehensive building electrification.

What does this look like? Efficient energy provision, used in the most effective way and limited loss.

Efficient energy provision, ensuring Heating, Ventilation, and Air Conditioning (HVAC) systems are working effectively and electric systems such as heat pumps. The electrification of buildings has been a priority in recent years to enable on-site renewable power generation, such as solar photovoltaics (PV) or using the electricity grid – which currently has a target to be decarbonised by 2035.

With renewable energy supply, the key is then to optimise the use. Even buildings capable of net-zero operation must ensure the efficient use of resources. This includes the deployment of smart technology to manage lighting, heating, and cooling systems intelligently, preventing inefficiencies such as heating spaces while windows remain open.

Finally, keeping it that way. Maintaining energy efficiency over time requires minimising energy loss through improved insulation, air sealing, double-glazing, and other measures that secure the building’s envelope.



2. **REnewable energy generation, large-scale and on-site**

With all buildings electrified, the aspiration is to ensure that the electricity is ‘clean’. This would mean building capacity for electricity grids to be fully decarbonised through large-scale projects, as well as on-site generation for properties which would be a requirement for net-zero energy classification (if the World Green Building Council definition is to be included in more specific definitions) and is attractive for owners and occupiers for a number of reasons including stabilised energy costs, ancillary income and reduced emissions.

At COP28, nearly 200 nations committed to tripling renewable energy output by 2030, underscoring a global consensus on energy transition.

Specifically, the UK aims to decarbonise its electricity grid by 2035, a significant step given that over half (51%) of its electricity was already generated from zero-carbon sources in 2023, with wind power alone accounting for almost 30%. Additionally, the surge in solar PV installations by 30% to a record 189,826 in 2023 reflects growing homeowner investment in renewable energy, as reported by the Microgeneration Certification Scheme (MCS). For real estate investors, offering properties powered by stable, zero-carbon electricity is not only appealing to tenants but also crucial for advancing environmental sustainability.

Achieving a comprehensive energy transition will require upgrades to grid infrastructure and significant investments in energy storage to manage consumption effectively, particularly during peak demand periods. *Our 2023 report* emphasises the strategic use of both 'grey' urban spaces and 'green' natural landscapes, including rooftops, car parks, and offshore sites, to accommodate renewable energy installations and support this transition.



3. REusing resources

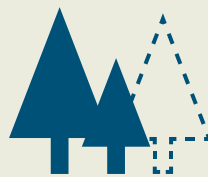
Inherent with reducing consumption of energy is reusing materials, reducing embodied carbon and lessening demands on scarce resources like water.

Despite the circularity concept gaining traction, its real-world application remains limited, with a decline in the use of secondary materials. *The Circularity Gap report* from Deloitte proposes 16 solutions that could reduce material extraction by a third, emphasizing the discrepancy between potential and current efficiency levels. Ideal circular construction, according to the report, hinges on public support, policy incentives, and mechanisms that value sustainability, including material passports and circular economy practices normalisation.

There is some movement towards implementing such measures with the revamped European Performance of Buildings Directive (EPBD) including a 'Buildings renovation passport', and UK planning authorities, such as those in London, mandating whole-life carbon assessments. We may also see more investor focus with the inclusion of embodied carbon emissions in new construction and major renovation projects in the 2023 GRESB Real Estate Standard, used by 2,084 real estate entities representing \$7.2 trillion gross asset value.

The growing trend of retrofit first is one that will only gather *pace in 2024*. Reusing materials, highlighted by the *Circularity in the Built Environment* report from WEF and McKinsey, estimates that Circularity could abate 75% of embodied emissions from the built environment by

2050. The report highlights not only environmental but sizeable economic rewards, with a potential annual net value gain of \$31-46 billion by 2030 and \$234-360 billion by 2050, through cost savings related to carbon taxes among other elements.



4. REstore nature

The Global Biodiversity Framework agreement and the 2023 Taskforce for Nature-related Financial Disclosures (TNFD) Framework underscore nature's pivotal role in our economy, contributing to half of the global GDP and supporting health, food security, and carbon capture. The surge in biodiversity and nature-themed fund investments, along with policy measures like the EU's deforestation regulation and the UK's biodiversity net gain requirements, signal a growing recognition of nature's value in real estate.



5. REengage stakeholders

Reengaging stakeholders addresses the 'Social' and 'Governance' aspects of ESG, emphasising ethical decision-making, transparency, and accountability. Social value, although challenged by definitional and measurement issues, remains crucial. Linking back to Edman's emphasis on outcomes over labels, the social dimension is integral to genuine sustainability efforts.

But is there something we are missing? There are two further RE's some might argue, but both of may become increasingly vital as we are reminded that progress in cutting emissions is slow?

That is REsilience and REMoving carbon or carbon capture, usage, and storage (CCUS) but regarding the technology rather than through nature. The former is important to plan for more extreme climates as the 12-months to February 2023 saw 1.5 degree warming about pre-industrial level so there is a need to be proactive, rather than reactive, and ensure buildings can operate in more extremes efficiently. The latter includes solutions such as direct air capture or bioenergy with carbon capture and storage (BECCS), both of which will need appropriate space and facilities to operate.

Transitioning to a sustainable built environmental involves significant action. By focusing on the outcomes; reducing energy consumption; embracing circular economy principles; restoring natural ecosystems; and engaging stakeholders, investors and actors within the real estate can take meaningful action towards achieving long-term value.

Mind the gap

The spotlight on the wealth carbon footprint gap has grown, we dissect how and why our framework is applicable for UHNWIS in addressing this

A new fascination has taken off, tracking private jets. Brought to the attention by Myclimate Carbon Tracker, among others, there has been media coverage such as “Private jets belonging to 200 celebrities, CEOs, oligarchs and billionaires have spent a combined total of 11 years in the air since the start of 2022” from *The Guardian*, highlighting growing noise around the wealth carbon footprint gap.

The wealth carbon footprint gap is best explained by a report by Oxfam and the Stockholm Environment Institute which states that the richest 1% of the global population is responsible for more emissions than the poorest 66%. This gap is exacerbated as individuals create vast emissions, yet can shelter from climate change’s most damaging effects due to mobility and ability to pay

Aside from their philanthropic endeavours, is there any evidence that wealthy individuals are endeavouring to change their habits and close the gap? In short, yes. According to our *Wealth Report 2024 Attitudes Survey*, almost two-thirds of UHNWIs are attempting to reduce their carbon footprint, while a fifth are trying to measure it.

“Wealthy families and UHNWIs have an increasing commitment to environmental responsibility,” notes Maryann Bell of Wingspan, a business designed to maximise family unity, business success and societal impact. She sees them “shifting lifestyles” but points out that this “actively requires intentionality”. Europeans are the most active, with three-quarters seeking to reduce their emissions, while those based in the Middle East are the least engaged, with 58% seeking cuts.

So what actions are UHNWIs taking? Let’s start with transport, where some 40% of UHNWIs are switching to electric vehicles (EVs). The International Energy Agency (IEA) predicts a yearly growth rate of 36% for EVs, and this rapid adoption will affect property owners and investors as charging facilities are increasingly sought in homes, offices, and retail locations.

“A report by Oxfam and the Stockholm Environment Institute states that the richest 1% of the global population is responsible for more emissions than the poorest 66%”

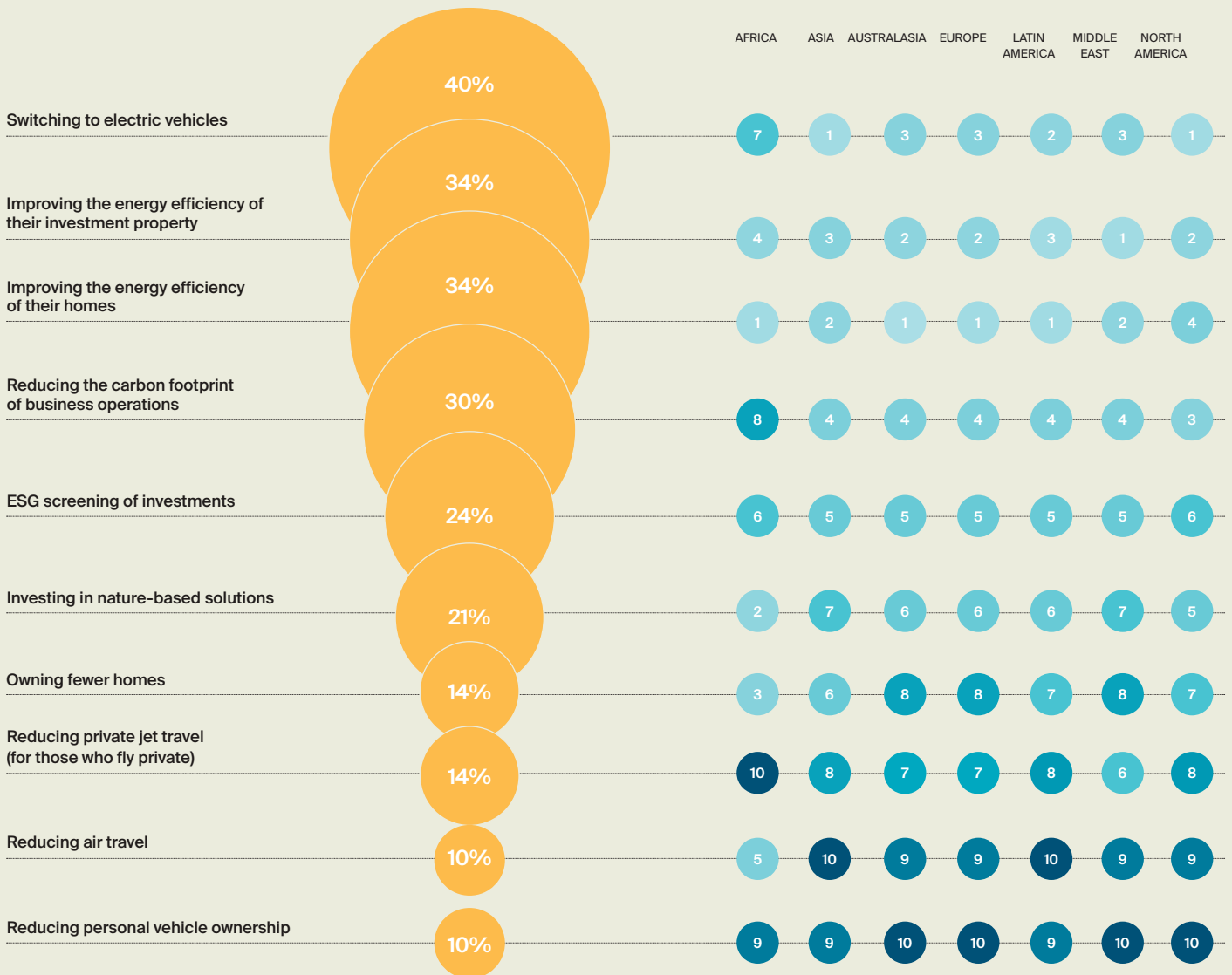
But not all transport is made equal: just 10% of UHNWIs plan to reduce air travel, while 14% intend to cut down on private jet use. “This is the hardest change as it has an efficiency and time element,” notes Bell. “But we are seeing a lot more conversations about offsetting that travel.” Change at an industry level is also making headway, with the first commercial transatlantic flight on sustainable aviation fuel taking off in November 2023.

Investment decisions and business operations are increasingly seen as tools for reducing emissions, with around a quarter of UHNWIs screening potential investments against ESG criteria. Wider adoption of ESG screening could mean more capital being directed to sustainable activities – and greater scrutiny over how businesses impact the



Taking strides

Proportion of UHNWIs taking the following actions to reduce their carbon emissions



Source: The Wealth Report Attitudes Survey

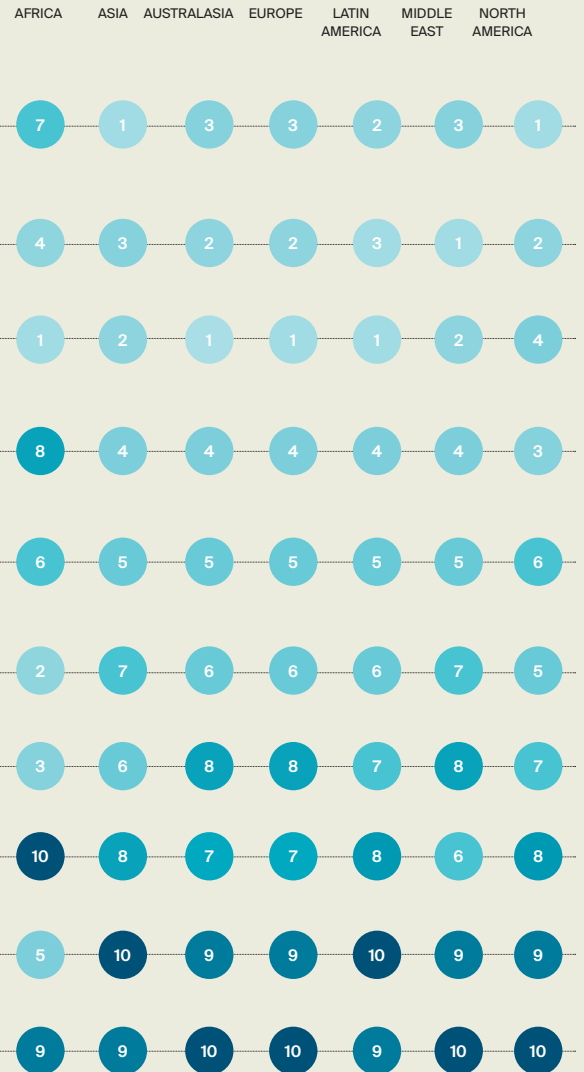
planet. Reflecting this, 30% of UHNWIs are reducing the carbon footprint of their business operations. While family-run businesses often do not require outside capital and therefore have limited accountability mandates, ESG can still be business-critical. “Family businesses encapsulate and share family values,” says Bell. “Environmental and social responsibility is at the forefront of minds and being recognised and communicated as part of those values.”

Two of the top three actions for reducing emissions were improving the energy efficiency of homes and investment property. Looking ahead, we can expect more attention to be paid to lifestyle externalities and the carbon wealth

“The IEA predicts a yearly growth rate of 36% for EVs and this rapid adoption will affect property owners and investors as charging facilities are increasingly sought in homes, offices and retail locations”

Shifting priorities

The most popular changes to lower emissions, ranked by % of UHNWIs doing each



gap. In a more transparent digital world, Bell points out, “there is no hiding.” Action – or lack of it – becomes more visible, and accountability more broad-based. We could also see governmental action: in January, Switzerland’s Young Socialists collected signatures for a national vote on a new tax on the wealthy to cover climate change costs.

Wealthy individuals too need to identify their sustainability goals and implement adjustments across all aspects of their lives to deliver these. As Bell muses, “it’s being elevated in the conversation, and whilst they may not be as good as they can be, they are trying and making active choices.”

Real Strategy

Real estate is a critical lever for UHNWIs in pursuing their sustainability goals. Here, we assess three of the Five REs of ESG, exploring the appetite from UHNWIs for each and highlight opportunities in these spaces.

RE 1: REDUCING ENERGY CONSUMPTION

How engaged are UHNWIs?

While improving energy efficiency in their homes and investment property is a top priority, UHNWIs may lack urgency compared with other investment actors. Our 2023 survey of 45 pan-European property investors found that more than threequarters were looking to improve their existing assets compared with just over a third of UHNWIs.

However, the spectre of more stringent energy efficiency minimums and demand from

“A report by Oxfam and the Stockholm Environment Institute states that the richest 1% of the global population is responsible for more emissions than the poorest 66%”

occupiers means that UHNWIs too will have to bring buildings in line in the near term. There is a broader trend of retrofitting and refurbishment. Just over a fifth of UHNWIs want to acquire and upgrade assets with weaker ESG credentials to upgrade or reposition, while almost 60% of the pan-European property investors surveyed are actively seeking poor-performing assets to improve/upgrade. However, retrofit is not for everyone. The predominant ESG investment strategy for UHNWIs has the potential to carry a lower risk profile, with 29% opting to invest in the most sustainable/prime assets.

What should be the focus?

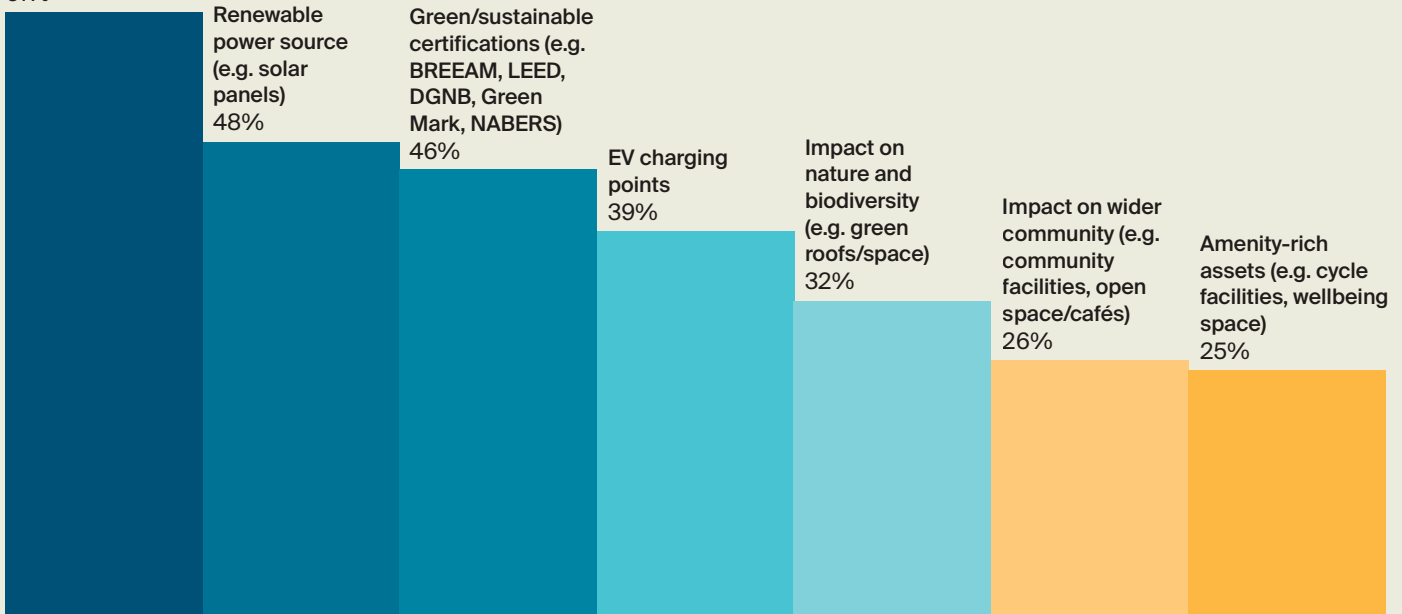
Energy efficiency ratings (such as Energy Performance Certificates or EPCs) are the clearest signal for UHNWIs, with 60% assessing property acquisitions against them. For the broader property investor market, some three-quarters of investors have a minimum certification requirement when acquiring new investment properties. Interest in green/sustainable certifications such as BREEAM, LEED, NABERS and Green Mark is growing, with 46% citing this as a consideration, up from 25% last year. When undertaking improvements, investors must consider the requirements of occupiers and future investors, including the need for data to show how

Efficiency is key

Proportion of UHNWIs using ESG-related criteria to assess property acquisitions



Energy Efficiency Rating (e.g. EPC)
61%



Source: The Wealth Report Attitudes Survey

buildings are being used. Thanks to the inexorable rise of the EV, 39% now look for EV charging when assessing a building for acquisition, up from 25% last year.

Furthermore, a quarter are assessing provision of amenities, compared with the 9% seeking cycle facilities in our 2023 report. Social and wellbeing aspects will come to the fore as more actors come to grips with the E side – indeed, the more forward-thinking are already making these areas a priority.

RE 2: RENEWABLE ENERGY CAPACITY

How engaged are UHNWIs?

More than a quarter of UHNWIs are planning to invest in renewable energy projects. The greatest appetite is among Europeans with 28%, followed by Asian UHNWIs with just over 27%. Others are not far behind, with 26% of North American UHNWIs pursuing this strategy.

What should be the focus?

Rooftop solar solutions can reduce or eliminate energy costs, lower emissions, potentially provide ancillary income and, particularly for investment property, increase capital value. Electricity grids globally need upgrades; on-site power generation and storage offer security of supply. For landowners, there are broader opportunities for ground-mounted solar and battery projects. “We have seen a number of UHNWIs seeking ways of using their land for renewable opportunities to diversify income as well as for sustainability objectives,” says David Goatman, Global Head of Energy and Sustainability at Knight Frank. “In addition, the market has witnessed sizeable rental growth of 10–20% per annum in recent years.”

RE 3: RESTORING NATURE

How engaged are UHNWIs?

Wealthy individuals are seeking opportunities to lower their emissions and secure returns, with 21% investing in nature-based solutions and 19% in carbon sequestration opportunities through land acquisition. Previous editions of *The Wealth Report* have looked at how UHNWIs are rewilding or protecting marine habitats. With the markets for nature evolving, be that biodiversity credits or carbon credits, the appetite for such projects looks likely to increase.

What should be the focus?

Almost a third of UHNWIs assess a building's impact on nature and biodiversity before acquisition. This trend is likely to build in the UK, for example, new developments now require

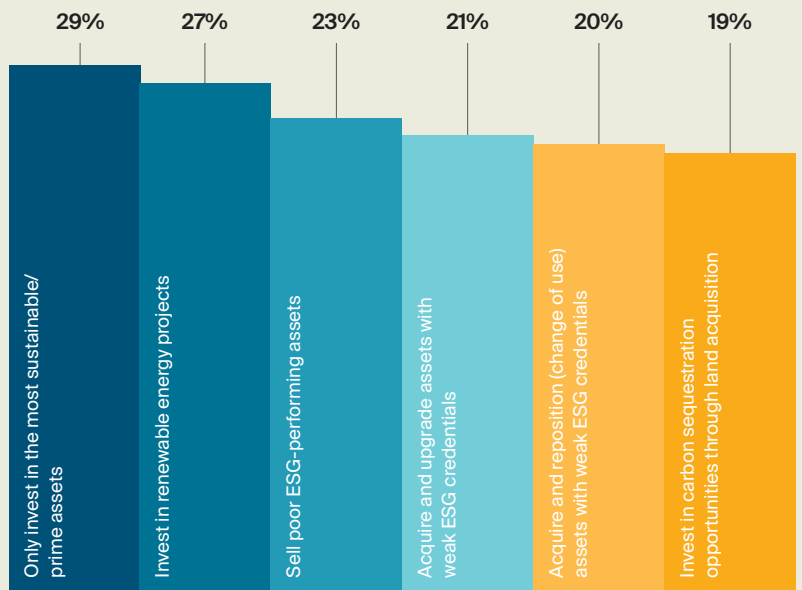
a minimum of 10% net biodiversity gain. The burgeoning market for “nature credits” presents an opportunity for private investors – albeit there is a need for rigorous attention to verifiable benefits to avoid any risk of “greenwashing”.

In navigating the complexities of sustainability within real estate, UHNWIs are pivotal in harnessing their investments towards a greener future. Their engagement in energy efficiency, renewable energy projects, and nature restoration can exemplify a commitment to closing the carbon wealth gap through making it a core principle to create long-term value.



Shaping an ESG strategy

Proportion of UHNWIs following each ESG strategy when investing in commercial real estate



Source: *The Wealth Report Attitudes Survey*
 Note: Respondents could choose multiple options

RATIONAL SUSTAINABILITY

After penning the Five RE's of ESG in *The Wealth Report 2024*, I read Alex Edmans concept of 'Rational Sustainability', which caught my attention and emphasizes the need for long-term value creation over political discourse. This combined with the RE's may be adding to the terminological landscape but help focus on the 'what' and 'how'.

Rational sustainability, Edmans reframing, boils down to ten elements, the first focus on the sustainability element and the final five, the rationality. He sets out that Rational sustainability is...

1. **About value creation, not politics**
2. **About outcomes, not labels**
3. **Intrinsic, not instrumental**
4. **Core, not peripheral**
5. **Enabling, not prescriptive**
6. **Builds on evidence and analysis**
7. **Recognizes diminishing returns and trade-offs**
8. **Sets boundaries**
9. **Guards against irrationality**
10. **Challenges and questions**

Fundamentally, it is bad business to ignore any so called ESG factor as it is an inherent risk but also should not include ESG factors as a tick box. In economic theory we are always taught about 'rational decision makers' but one thing we know is that is far from reality. Markets, consumers, decision makers may not behave in a way that is 'rational'. The new framing of ESG can shine a light on what rationality means for long-term value creation.

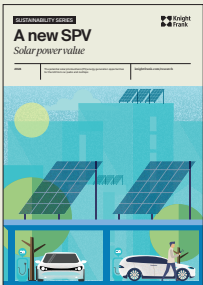
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