

Sustainable Assets, Sustainable Returns:

Unveiling the ESG-Rental Premiums Nexus

May 2024

This research offers empirical evidence on the influence of ESG provisions on the rental prices of office buildings in Hong Kong. Additionally, it provides valuable insights into investment decisions related to ESG enhancement.

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“The Asia-Pacific region is witnessing a growing trend known as the “flight to quality, which is accompanied by an increasing number of ESG disclosure regulations at both corporate and asset levels. Building owners should strategically plan their ESG upgrades to align with this trend rather than focusing solely on task-driven upgrades.



By doing so, landlords can unlock the potential for ESG premiums, mitigate the risk of brown discounts, and position themselves for higher occupancy rates and rental resilience. These advantages are particularly important during market downturns.”

Jackie Cheung
Director
ESG, Asia-Pacific

“In Hong Kong, office tenants, particularly Hong Kong-listed enterprises, are currently placing a significantly greater emphasis on ESG features when making real estate decisions. In view of the ESG premiums, certain landlords are demonstrating a relatively swifter response compared to others. Their focus extends beyond the environmental aspect and encompasses the social and governance dimensions as well.



While Hong Kong aims to achieve carbon neutrality by 2050, multinational corporations are expected to adhere to the standards established by their global headquarters, potentially as early as 2027-2030.”

Martin Wong
Senior Director
Head of Research & Consultancy, Greater China



1. Introduction

In the evolving landscape of commercial real estate, the significance of Environmental, Social, and Governance (ESG) factors has become increasingly prominent. It has become a critical factor for real estate decisions, from investment decisions to corporate sustainability plans of landlords and occupier's requirements. As global awareness of sustainability grows, the integration of ESG principles into business strategies is no longer a choice but a necessity. This paper delves into the critical role of ESG in the commercial real estate sector.

The focus of our research is on understanding how each ESG factor influences the rental premium in the Hong Kong office market. Rental premiums are subject to various factors – location, building specifications and quality, to name a few – among which, ESG has emerged as a potent factor. With businesses becoming more conscious of their social

responsibility and environmental impact, office buildings that adhere to ESG principles are likely to command a rental premium.

This paper provides empirical evidence of the sensitivity between ESG parameters and rental premiums by conducting a comprehensive survey of 181 representative office buildings across various commercial districts in Hong Kong Island and Kowloon. These statistics can help landlords and investors determine the most sustainable path for integrating ESG criteria into assets while considering the ever-changing sustainability landscape. This can also help occupiers select a long-term resilient workspace that is aligned with their ESG framework. By understanding the potential financial impact of integrating ESG into asset management, stakeholders can make informed decisions that result in long-term profitability and resilience.

1.1 Key Takeaways



Every enhancement of ESG-related criteria can contribute to up to **17.1% of rental premium**.



Sustainable certification is becoming a screening criterion to avoid **brown discounts**.



43% of buildings surveyed conducted sustainable buildings accreditation, and more to come.



Integrating ESG-related criteria beyond sustainable certifications unlocks substantial **green premiums**.



The top three ESG-related criteria considered rental sensitive in Hong Kong are EV charging infrastructure, Art and Culture Integration, and Green Pledge.

1.2 Challenges for HK Landlords in ESG Implementation

In Hong Kong, the decision-making process for asset owners in choosing upgrades for their buildings often relies on requests from investors, rating agencies and occupiers. Pioneer developers have taken a step further by establishing their own vision for ESG considerations, which serve as a guiding principle for determining which ESG parameters should be prioritised.

Some critics argue that ESG criteria are overly broad or excessively influenced by 'woke' culture. Landlords face the challenge of a growing number of ESG-related certifications and ESG ratings that they must navigate to meet the expectations of investors and occupants. While certifications have traditionally been a straightforward strategy to avoid

brown discounts, rising ESG regulations can shift the dynamic materially over time. Consequently, landlords may continuously pursue and maintain various thematic certifications to meet evolving requirements. This cycle of obtaining and renewing certifications could be non-cost-effective in the long run.

This paper proposes an integrated and macro approach to prioritising ESG parameters in real estate stakeholders' assets. By identifying key investment and asset enhancement areas that align with emerging trends, asset owners can ensure their buildings are well-positioned for success in the rapidly evolving ESG-focused market to secure long-term benefits.

2. Approach and Methodology

A total of 181 representative and active office buildings across various commercial districts in Hong Kong Island and Kowloon were surveyed to study their ESG provisions. The buildings were divided into six district groups, as follows:

Table 1: Number of Office Buildings Surveyed by District Groups in Hong Kong

Region	District Group	No. of Buildings Surveyed
Hong Kong Island	Central / Admiralty / Sheung Wan	46
	Wan Chai / Causeway Bay	24
	Island East	24
Kowloon	Kowloon Central	25
	Kowloon East	41
	Kowloon West	21

A multi-variable linear regression¹ was applied to evaluate the empirical relationship between the office rent of the selected buildings and their corresponding building-specific variables and sustainability features. The following multi-variable linear regression equation was adopted:

$$\text{Office Rent} = \text{constant coefficient (c)} + \beta_x \text{ Total ESG Score} + \beta_y \text{ Location} + \beta_z \text{ Building age}$$

Once an individual variable was found to be statistically significant at a 95% confidence interval, the rental premium of the variable was examined. The following equation was adopted to obtain the rental premium (%):

$$\text{Office Rental Premium (\%)} = \frac{\text{Variable Coefficient } (\beta_x \text{ or } \beta_y \text{ or } \beta_z)}{\text{Constant Coefficient (c)}}$$

2.1 Office rent

According to Knight Frank's in-house database, the office rental data was based on the levels recorded in Q1 2024 on a net effective basis. Direct comparisons between Hong Kong Island and Kowloon office buildings are allowed.

2.2 Building-specific variables

In this study, several building-specific variables, including location, building age, sea view, and ceiling height, were examined. However, after conducting a multi-variable regression analysis, only location and building age were found to have a statistically significant impact. As a result, this analysis focused solely on considering location and building age as influential factors.

2.3 Location

Each office building was assigned a location score based on its proximity to the existing central business district (CBD) in terms of travelling time. A higher score indicates a proximity to Central, whilst a lower score indicates a far distance away from Central. This score takes into account the cost associated with travel time, providing an assessment of the building's convenience and accessibility in relation to the CBD.

Table 2: Assigned Score and Respective Travelling Time of Office Buildings Surveyed by District Groups in Hong Kong

Location	Score	Travelling Times (minutes from Central)
Central	10	0
Admiralty, Sheung Wan	9	5
Wan Chai, Causeway Bay	8	7
Island East	7	10
Tsim Sha Tsui	6	11
Hung Hom	5	12
Mong Kok, Kowloon Tong	4	13
Kai Tak, Kowloon Bay, Kwun Tong	3	15
Cheung Sha Wan, San Po Kong	2	17
Kwai Chung, Tsuen Wan	1	20

¹Market dynamics were not taken into account.

2.4 Building age

The year in which the building obtained the occupation permit (OP) is considered as its starting year. It should be noted that certain buildings may have undergone renovations or upgrades. The surveyed office buildings have an average age of 23.9 years.


Table 3: Average Age of Office Buildings Surveyed by District Groups in Hong Kong

Region	District Group	Average Age (years)
Hong Kong Island	Central / Admiralty / Sheung Wan	32.9
	Wan Chai / Causeway Bay	30.1
	Island East	21.4
Kowloon	Kowloon Central	28.6
	Kowloon East	13.4
	Kowloon West	14.6
All		23.9

2.5 Assessed ESG Parameters

In order to quantitatively evaluate the ESG provisions in the office buildings, a comprehensive assessment was conducted for each building, considering a total of 24 ESG parameters. These parameters were carefully selected, considering their alignment with global trends as indicated in *The Knight Frank Wealth Report 2023* and *2024*, and their relevance to the specific context of Hong Kong. Each parameter was assigned a score ranging from 0 to 1, reflecting its presence and performance within the assessed office building. The overall ESG score for a building is determined by the cumulative score of all 24 parameters. The following table provides a concise summary of the ESG criteria.

Table 4 : List of 24 ESG parameters

Environmental			
	E1	BEAM Plus* building accreditation	BEAM Plus (Building Environmental Assessment Method Plus) is the prevailing green building rating tool in Hong Kong. Under this system, buildings are assigned rankings based on their sustainability achievements.
	E2	LEED* building accreditation	LEED (Leadership in Energy and Environmental Design) is the world's most widely used green building rating system.
	E3	Renewable energy	Landlords provide energy derived from natural sources, e.g. solar panels, wind turbines, biodiesel generators, etc. in the building.
	E4	EV charging infrastructure	Landlords provide electric vehicle (EV) charging stations/ infrastructure in the office car park of the building.
	E5	Energy consumption monitors	Landlords provide separate energy meters or energy audits to tenants in the building.
	E6	Water reduction provisions and recycling systems	Landlords provide water reduction facilities, e.g. rainwater recycling, low-flow faucets, etc., in the building.
	E7	Water consumption monitors	Landlords provide separate water meters or water audits to tenants in the building.
	E8	Waste data collection	Landlords provide collected recycling and general waste data to tenants in the building.
	E9	Resilience to extreme climate conditions	Landlords carry out the scenario analysis and implement resilience measures at both corporate and building levels.
	E10	Biodiversity and conservation	Landlords contribute to the ecology by engaging in initiatives such as urban farming, tree planting, and installing bird boxes and beehives in the building.



Social		
S1	WELL* building accreditation	The WELL Building Standard is an international system that measures, monitors, and certifies a series of features that promote occupant well-being.
S2	Indoor air quality monitoring system	Landlords provide indoor air quality (IAQ) monitoring systems that allow users to monitor air quality in a building's indoor environment.
S3	Public transport walkability	The building is located within a 10-minute walking distance from the nearest bus, minibus and MTR stations.
S4	Neighbourhood amenities	Within a 500-meter radius of the building, there are at least 15 neighbourhood amenities, such as a fitness centre and food and beverage outlets.
S5	Open space	Landlords provide open areas such as podiums and sky gardens with benches for leisure and relaxation in the building.
S6	In-house amenities	Landlords provide in-house amenities, e.g., nursery rooms, gyms, or exercise areas, within the building.
S7	Art and culture integration	Landlords provide dedicated space for art and cultural activities and exhibitions within the building.



Governance		
G1	Building management and smart control systems	Landlords incorporate building management and smart control systems, such as an IoT network, Building Information Modelling (BIM), Artificial Intelligence (AI) application, smart lighting control, smart air conditioning control, mobile application control, etc., within the building.
G2	Corporate carbon reduction target	Landlords have established corporate carbon reduction targets to reduce greenhouse gas (GHG) emissions.
G3	Transparent ESG reporting	Landlords publish annual disclosures that align with local or global ESG reporting standards at the corporate level.
G4	Security access	Landlords provide security control, e.g. access gates, and visitor registers within the building.
G5	Green pledge and/or green fit-out guide	Landlords provide green pledge options to tenants by incorporating sustainability principles, e.g. water and energy conservation, waste reduction and recycling, into lease agreements and/or Landlords provide a green fit-out guide to tenants by undertaking sustainability considerations, e.g. using non-hazardous materials and energy-efficient electrical appliances.
G6	Tenant engagement programme	Landlords implement tenant engagement programmes, e.g. sustainability-related workshops, campaigns or events to engage and educate tenants actively.
G7	WiredScore and SmartScore* building accreditation	WiredScore promotes the quality and reliability of digital connectivity within a building, including internet connectivity, network infrastructure, and other related factors. SmartScore recognises technologically advanced smart buildings that deliver exceptional user experiences, drive cost efficiency, and meet high sustainability standards.

* Note: Scores are counted for buildings that have acquired final certification.

3. Findings

3.1 Descriptive Analysis of ESG Variables

In terms of the ESG total scoring of the 24 parameters, a majority of the buildings fall within the 50th percentile, accounting for 36% of the surveyed buildings. Only 28% of the buildings achieved a score of over 50% in the ESG assessment, indicating that some buildings are making efforts to implement an ESG enhancement plan but still have room for improvement, as shown in Chart 1. Chart 2 illustrates the distribution of the surveyed buildings based on their E-, S-, and G-scores. Approximately 54% of the buildings scored lower in the E-criteria, while over 50% of the buildings performed better in the 75th and 100th percentile for both S- and G-criteria. Overall, office buildings in Hong Kong demonstrate stronger performance

in the S- and G-criteria than the E-criteria. This discrepancy could be attributed to the higher capital costs associated with implementing E-criteria compared to the other two categories.

Of the surveyed buildings, 43% have attained sustainable certifications, including BEAM Plus, LEED, WELL, WiredScore and SmartScore. As no marks were assigned to the buildings under pre-certification in this study, it is expected that more buildings will achieve sustainable certifications in the near future. Chart 3 reveals that among the 77 buildings that have obtained sustainable certifications, 70% of them are located in Hong Kong Island, while the remaining 30% are situated in Kowloon.

Chart 1. Distribution of ESG Scoring for Surveyed Office Buildings in Hong Kong

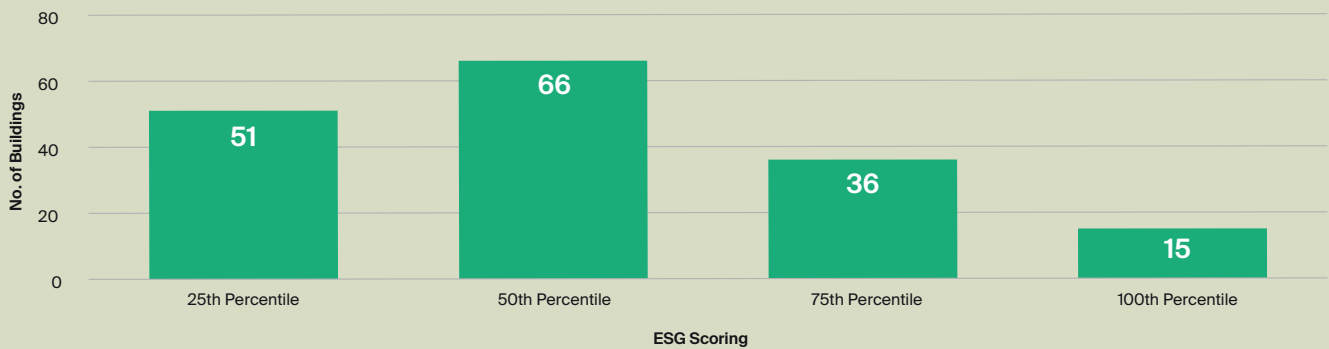


Chart 2: Distribution of Detailed ESG Scoring for Surveyed Office Buildings in Hong Kong

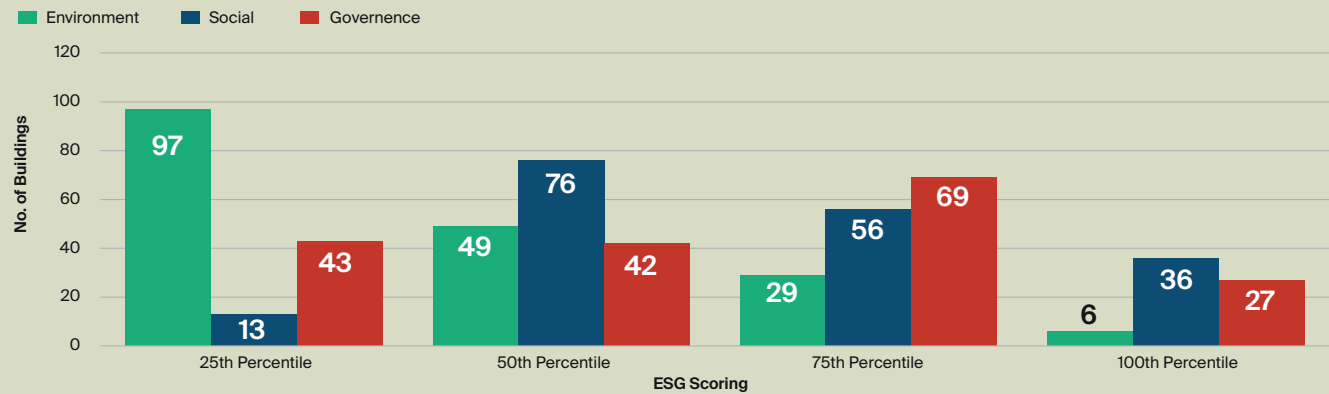
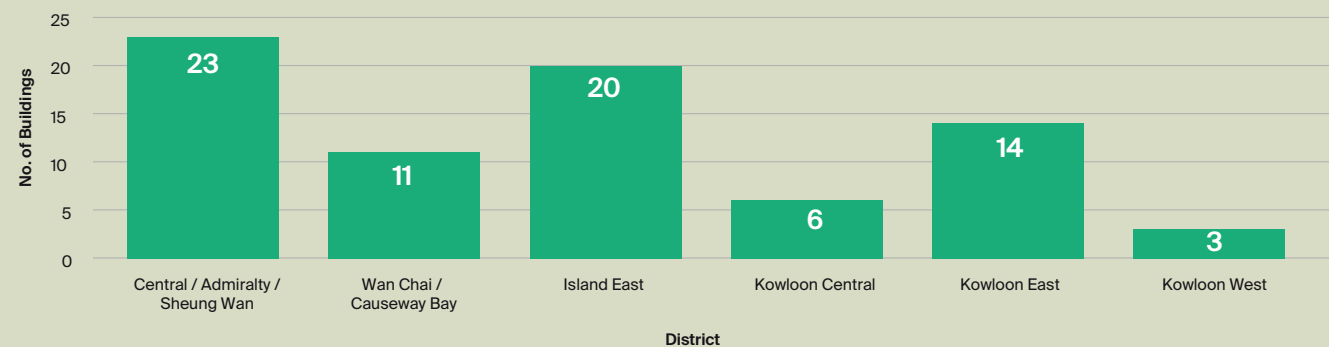
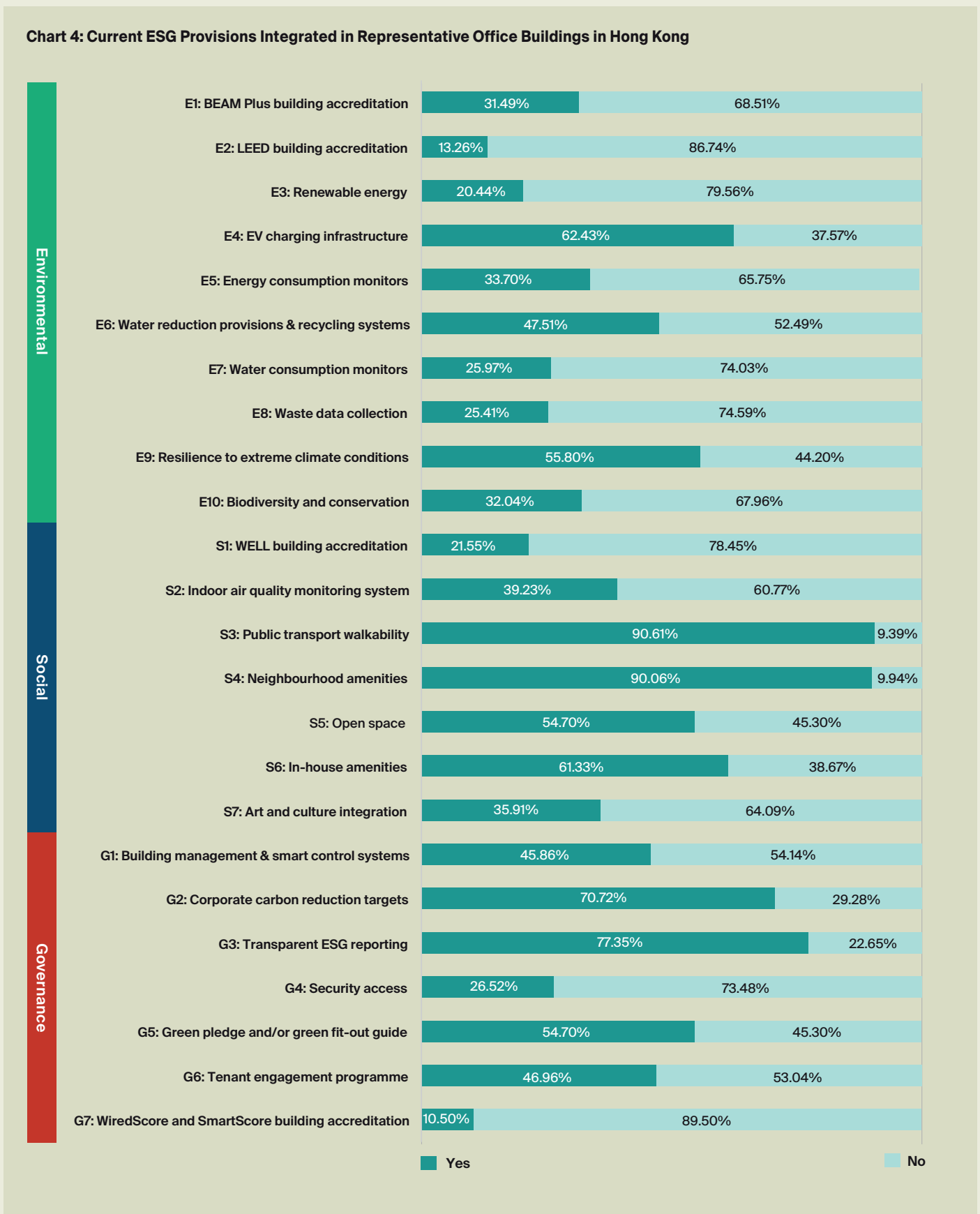


Chart 3: Distribution of Office Buildings in Attaining Sustainable Certification by District Groups in Hong Kong






3.2 ESG Maturity

Chart 4 presents a comprehensive overview of the existing ESG provisions across all 24 parameters in the context of representative office buildings in Hong Kong. The chart effectively illustrates the distribution of buildings that have implemented or have yet to implement each ESG provision, providing valuable insights into the current status and progress in these areas. This analysis highlights both areas of advancement and opportunities for further improvement. For additional details and findings, please refer to Table 5.



Apart from attaining sustainable building certifications, the survey revealed that landlords have made further strides in equipping their office buildings with various ESG provisions. The summarised survey results of 181 representative office buildings are presented in the table below:

Table 5: Summary of ESG Findings

 Environmental	 Social	 Governance
<ul style="list-style-type: none"> • Across all districts, 31% of buildings have attained BEAM Plus certification, while 14% have achieved LEED certification. • Approximately 62% of Hong Kong and Kowloon office buildings have EV charging infrastructure. However, 98% of these developments have less than 50% of their parking spaces equipped with charging provisions. • More than half (56%) of the surveyed buildings have taken action to mitigate extreme climate conditions. • Only 20% of the surveyed office buildings use renewable energy. • Less than half of the surveyed office buildings provide energy and water consumption monitors, or waste collection data for tenants, or integrated biodiversity and conversation features. • In terms of lettable area, less than half of the surveyed buildings provide tenants with separate energy consumption monitors, water consumption monitors, or waste data collection. • In terms of common areas, one-third of the buildings provide integrated biodiversity and conservation features. 	<ul style="list-style-type: none"> • 22% of the surveyed office buildings attained WELL certification. • Approximately 91% of office buildings are within 10-minute walking distance to public transport, and 90% of them have neighbourhood amenities. • About 61% of the surveyed office buildings are equipped with in-house amenities, and 55% of them are close to open space. • Less than 40% of office buildings have installed indoor air quality monitoring systems. • 36% of the office buildings have dedicated space for art and culture activities or exhibitions. 	<ul style="list-style-type: none"> • About 71% of the surveyed office buildings have corporate carbon-reduction targets, and 77% of the landlords have transparent ESG governance reporting practices. • Around 55% provide green pledges or fit-out and refurbishment guides with sustainability considerations. • Close to half (47%) of the buildings provide a tenant-engagement programme, and 46% are equipped with building management and smart control systems. • 27% of buildings are partly or fully equipped with access security. • About 11% of the buildings have achieved smart building certification, such as WiredScore and SmartScore.

The average ESG score across all districts is 10.1, with an ESG coverage ratio of 41.9%. Island East emerges as the frontrunner with the highest average ESG score of 12.6 and coverage ratio of 52.5%. It is closely followed by the Central district, with an average ESG score of 11.2 and a coverage ratio of 46.7%.

Table 6: Average ESG Score across All Districts

Region	District Group	Average ESG Score (out of 24)	ESG Coverage Ratio
Hong Kong Island	Central / Admiralty / Sheung Wan	11.2	46.7%
	Wan Chai / Causeway Bay	10.6	44.2%
	Island East	12.6	52.5%
Kowloon	Kowloon Central	10.1	42.1%
	Kowloon East	7.9	32.9%
	Kowloon West	7.9	32.9%
All		10.1	41.9%

3.3 ESG Premium

Based on the regression outlined in Section 2, the rental level was regressed on 1) Total ESG Score, 2) Location and 3) Building age variable. The following output shows the coefficients and significance of each variable:

$$\text{Rental level} = 6.81 + 1.16 \text{ Total ESG Score} + 6.63 \text{ Location} - 0.39 \text{ Building Age}$$

Table 7: Summary of Rental Premium Result

Rental Premium	
Total ESG Score	+17.1% for each enhancement of ESG-related criteria
Location	+97.3% for each enhancement of Location score
Building age	-5.7% for each additional year of Building age

The regression analysis results found that a rental premium of 17.1% exists for each enhancement of ESG-related criteria. The regression also revealed that the variables of location and building age have a statistically significant impact on rental premiums, with a 95% confidence interval. This validates the inclusion of these variables in the multivariable regression model.

The understanding of rental premiums in this context can be approached from two perspectives. On one hand, it can be interpreted as an additional rent of 17.1% for every single point increase in the total ESG score, commonly referred to as the “green premium.” This assumption is made under the condition that leasing strategies and approaches remain consistent across all buildings. On the other hand, it can be understood as a potential rental discount of 17.1% for every single point decrease in the total ESG score, known as the “brown discount”. In essence, this implies that landlords may experience a comparative disadvantage if the ESG provisions of their building are less robust compared to those of their competitors.

3.4. Priority in Investment and Enhancement Plan

Achieving a higher ESG score can be pursued through various approaches, potentially leading to an increase in rental premiums. However, it is crucial to make decisions while considering capital costs and implementation time, as these costs may vary from one case to another.

To provide asset owners with guidance on prioritising enhancements based on macro statistics, rather than solely relying on the total ESG score, each ESG parameter underwent an additional round of regression analysis within the same framework. This analysis aimed to determine the individual sensitivity of rental prices to specific ESG parameters. While some of these regressions on individual ESG parameters may not yield statistically significant results at the 95% confidence interval, the majority of them demonstrate statistical significance at the 80% confidence interval. This suggests that certain ESG elements exhibit greater sensitivity to rental prices compared to others. The priority list for these elements is as follows:

Table 8: Rental Sensitivity Ranking of Environmental Parameters

Rental Sensitivity	Environmental Parameters
1	EV charging infrastructure
2	Renewable energy
3	Resilience to extreme climate
4	Water reduction provisions and recycling systems
5	Water consumption monitors
6	LEED building accreditation
7	BEAM Plus building accreditation
8	Biodiversity and conservation
9	Waste data collection
10	Energy consumption monitors

Table 9: Rental Sensitivity Ranking of Social Parameters

Rental Sensitivity	Social Parameters
1	Art and culture integration
2	In-house amenities
3	Open space
4	Neighbourhood amenities
5	Indoor air quality monitoring system
6	Public transport walkability
7	WELL building accreditation

Table 10: Rental Sensitivity Ranking of Governance Parameters

Rental Sensitivity	Governance Parameters
1	Green pledge and/or green fit-out guide
2	Security access
3	Corporate carbon reduction target
4	Building management and smart control systems
5	Tenant engagement programme
6	Landlord transparent ESG governance reporting
7	WiredScore and SmartScore building accreditation



4. Recommendations

4.1 Turning statistics into an action plan

Beyond the traditional focus on energy efficiency (E-score) in regulatory requirements, a growing trend among investors involves evaluating the legal and voluntary disclosure of overall ESG performance. This includes managing stranded asset ESG risks and ensuring access to funding.


The landscape of ESG premiums in the real estate sector is evolving beyond basic building certifications and energy efficiency measures. Driven by increased investor scrutiny and a growing understanding of the interconnectedness of ESG factors, these trends demand a more holistic and accountable approach to ESG integration. Before investors and landlords determine the most appropriate ESG enhancement plans, there are four crucial considerations to explore.

“Certification has been a typical screening criterion to avoid brown discounts. But what’s next to obtain accountable ESG premiums?”

4.2. Considering Investors’ Needs


According to *The Knight Frank Wealth Report 2024*, energy efficiency remains the paramount ESG criterion for global investors when evaluating property acquisitions. Energy efficiency ratings serve as a clear signal for ultra-high-net-worth individuals (UHNWIs), with 60% factoring them into their acquisition decisions.

EV Charging Infrastructure



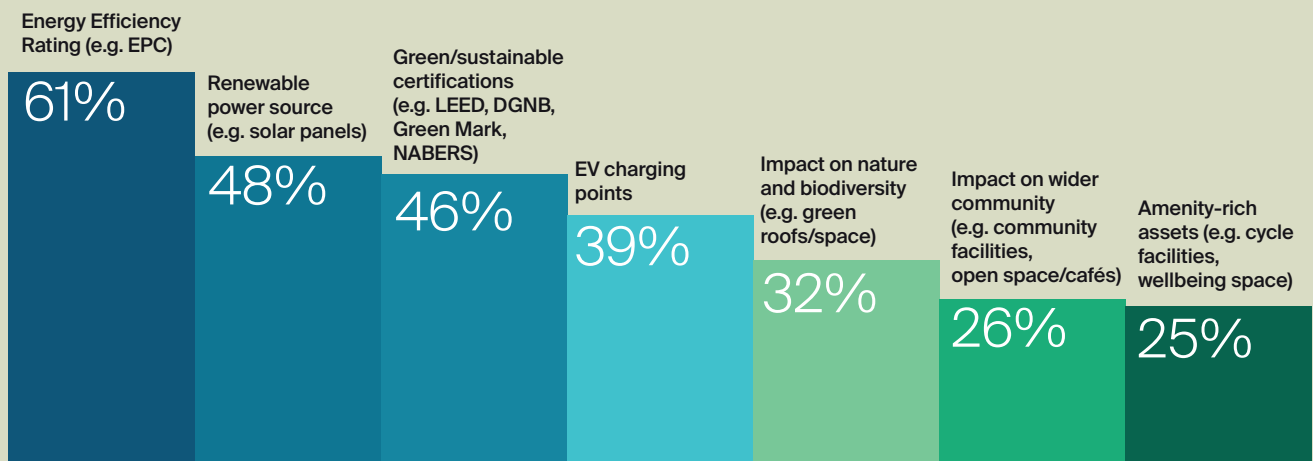
The surge in electric vehicles (EVs) has prompted a significant shift in investor priorities. The report reveals that 39% of investors now prioritise EV charging facilities when assessing a building for acquisition, up from 25% in 2023. Switching to EVs offers a substantial reduction in greenhouse gas emissions from corporate vehicles used by landlords and tenants. In the 2023 Policy Address, the HKSAR Government, recognising this trend, aims to expand the network of EV charging facilities, targeting approximately 200,000 parking spaces with charging infrastructure by mid-2027. However, with only 3% of office buildings currently equipped with EV charging facilities, this area has significant room for improvement, indicating a strong and sustained demand for EV charging points in Hong Kong.

Renewable Energy



The transition to clean energy sources is gaining momentum and has become a key screening criterion for occupiers, particularly multinational companies. *The Knight Frank Wealth Report 2024* reveals that 49% of investors in Asia use renewable energy as a parameter when assessing property for acquisition, exceeding the global average of 48%. The HKSAR Government plans to initiate legislative amendments to the Buildings Energy Efficiency Ordinance (BEEO) in 2024, emphasising the inevitability of improving building energy efficiency. Increasing the use of renewable energy and installing separate energy meters to track energy consumption are effective strategies for enhancing energy efficiency, promoting energy conservation, and driving decarbonisation. While the push for renewable energy installation is evident, this study highlights that only 20% of surveyed office buildings have actually implemented renewable energy solutions. This gap is attributed to constraints imposed by Hong Kong’s building infrastructure, high initial capital expenditure, and limited floor space for renewable energy equipment installation.

Chart 5. Proportion of UHNWIs using ESG-related criteria to assess property acquisitions



Source: *The Knight Frank Wealth Report 2024*, Attitudes Survey

4.3. Considering Occupiers' Preferences

According to the *Knight Frank Cresa 2023 (Y)our Space Survey*, the influence of ESG considerations on real estate decisions is on the rise. ESG ranked sixth among the top strategic initiatives supported by corporate real estate, with 17% of respondents mentioning it, marking an improvement from its 10th position in the 2021 survey. This suggests a narrowing gap between corporate ambition and action on ESG, particularly among larger organisations.

As more stakeholders prioritise and address the environmental (E) aspects of ESG, social and well-being considerations will increasingly take centre stage. In fact, forward-thinking organisations are already making these areas a priority.

“Nearly three-quarters of respondents believe that ESG ambitions will moderately or significantly impact their real estate decisions over the next three years compared to just over half of respondents in 2021.”

Art and Culture Integration



“Art and culture integration” is the most rental-sensitive S-factor, yet only 36% of office buildings currently provide such spaces. Occupiers increasingly value experiences and placemaking. Transformation of common spaces into creative hubs is encouraged. The

Hong Kong government’s statistics reflect this trend, with financial support allocated to the creative and cultural industries increasing by 45% from HK\$4.7 billion to HK\$6.8 billion between 2018 and 2024. This trend is mirrored within the corporate sphere, as landlords increasingly incorporate art installations, cultural events, and partnerships with local artists into commercial premises.

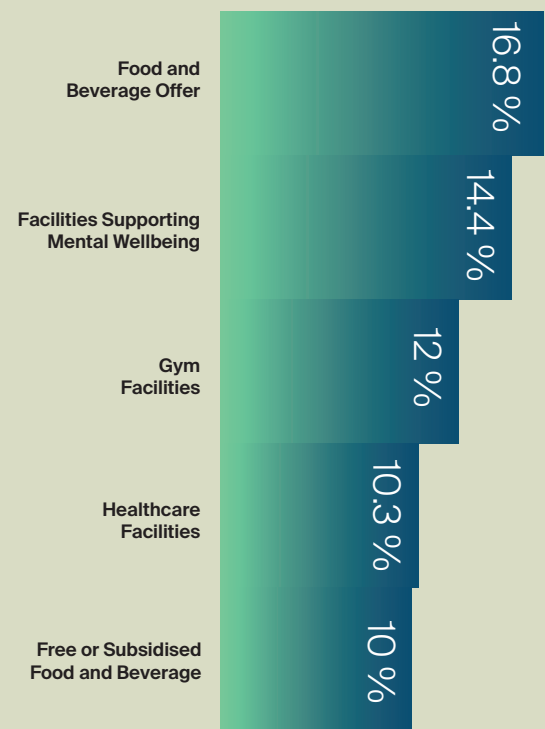
In-house Amenities



In-house amenities supporting physical and mental well-being, such as gym facilities and open space areas, are becoming increasingly expected by occupants, as highlighted in *(Y)our Space 2023 Survey*. These amenities rank second in terms of rental sensitivity in

the study. While the range of amenities sought by tenants remains diverse, well-being is now a central focus. This elevated position reflects growing concerns about mental health in the workplace and the increasing expectation that employers prioritise this aspect alongside employee well-being. Good mental health is crucial for productivity, so employers’ concerns extend beyond altruism or compassion - they are driven by an economic imperative.

Chart 6: Evolving the flight to quality and amenities



Source: *The Knight Frank Cresa 2023 (Y)our Space Survey*

4.4. Considering Local Policies

Hong Kong’s real estate sector faces a significant challenge in reducing its environmental impact. Buildings account for approximately 90% of the city’s electricity consumption and over 60% of its carbon emissions. The Hong Kong Climate Action Plan 2050 (HKCAP2050) outlines a strategy to decarbonise the sector, aiming to reduce commercial building electricity consumption by 30% to 40% from 2015 levels by 2050, with half of these targets to be achieved by 2035 under the “Energy Saving and Green Building” pillar.

The Chief Executive’s 2023 Policy Address stated that the HKSAR Government would propose amending the BEEO, including extending the scope of regulation to more types of buildings, mandating the disclosure of information in energy audit reports, and shortening the interval of energy audits. The target timeline is to commence the legislative exercise in 2024.

Waste Collection and Recycling



The government will implement Municipal Solid Waste Charging (MSW charging) on 1 August 2024. This initiative, based on the “polluter-pays” principle, will charge all sectors in Hong Kong for waste disposal

based on its quantity. Currently, only 25% of surveyed buildings collect waste data for tenants. However, implementing MSW charging is expected to alter building landlord behaviour significantly. Increased recycling streams and onsite waste compression facilities are potential solutions to address this challenge.

Security Access



The study reveals that security access is a crucial parameter, ranking second in terms of rental sensitivity in the G-factor. Top-tier office buildings are distinguished by their incorporation of advanced security access measures and intelligent building management systems, enhancing the allure, safety, and convenience of the premises for tenants.

Resilience to Extreme Climate



The lessons learned from losses from extreme typhoons and floods in Hong Kong in recent years have accelerated the implementation of climate mitigation and adaptation measures, such as installing flood gates and reviewing facade and rooftop resilience to wind load.

Climate disclosure and management requirements, such as IFRS S2 Climate-related Disclosures, the Hong Kong Stock Exchange (HKEX) ESG Reporting Code, and the Supervisory Policy Manual, have stimulated enhancements in climate resilience by predicting future climate scenarios at the asset level. The HKEX published conclusions to its consultation on enhancing climate-related disclosures under its ESG

framework in April 2024, aligning more closely with IFRS S2 Scope 1 and Scope 2 GHG emissions disclosure will become mandatory for all listed issuers in Hong Kong for financial years commencing on or after 1 January 1, 2025. Landlords are expected to strengthen their internal governance and climate risk management processes.

Meanwhile, the Securities and Futures Commission has also issued Consultation Conclusions on the Management and Disclosure of Climate-related Risks by Fund Managers, requiring Type 9 asset managers, including real estate fund managers, to consider climate-related risks in their investment and risk management process. These developments, along with other global ESG investment considerations, are shaping the future of Hong Kong's real estate sector.

4.5. Considering Global Regulations and Compliances

Global investors are increasingly align their practices with the Sustainable Finance Disclosure Regulation (SFDR) and EU Taxonomy compliance. These trends, coupled with growing investor demands, make climate assessment (Task Force on Climate-Related Financial Disclosures or "TCFD"), nature integration (The Taskforce on Nature-related Financial Disclosures or "TNFD"), and taxonomies crucial considerations for investment decisions. Regional taxonomies, such as the EU Taxonomy and the Prototype of a Green Classification Framework for Hong Kong, provide investors with standardised information about their investments, reducing information asymmetry and facilitating better decision-making to mitigate long-term ESG risks. As a result, investment ESG due diligence is becoming as crucial as building surveys during the technical screening process for acquisitions.

Green Lease



ESG considerations are increasingly influencing lease negotiations globally. Knight Frank has observed a growing interest from landlords and tenants in sustainable buildings, decarbonisation strategies, and best practices for achieving sustainability targets during the occupancy stage, including fit-outs and operational practices. *The Knight Frank' ESG Property Investor Survey*

Q3 2023 reinforces this trend, revealing that 100% of surveyed investors utilise green leases.

There is a growing demand for green fit-outs and green leasing in Hong Kong, potentially influenced by international awareness. France mandates green lease clauses for all commercial premises exceeding 2,000 sqm. At the same time, the Australian government requires all governmental agencies and departments to formulate green leases for all government-owned and occupied buildings.

4.6. The Importance of ESG and Climate Due Diligence

To stay in line with the latest investment trends, conducting an **ESG assessment** is of utmost importance. Conducting a feasibility study for asset enhancement initiatives with ESG provisions in the selected buildings and cash flow studies is advised. **Feasibility studies** for each asset can further investigate the effectiveness and viability of investing in ESG provisions within the building. By carefully assessing selected buildings and identifying areas for improvement, informed decisions can be made regarding the allocation of funds, whether for upgrading outdated infrastructure, enhancing energy efficiency, or implementing innovative technologies.

Furthermore, it is crucial to conduct climate risk assessments to keep pace with global investment trends. A high-level risk scenario analysis can be undertaken

to determine the climate risk exposure of a property or portfolio, followed by identifying short-, medium-, and long-term climate-related risks and opportunities. Anticipated financial impacts of high-risk assets can be analysed using appropriate financial and valuation tools and data from selected scenarios as the next step in quantifying the results of climate risk assessment. One of the metrics adopted for quantifying financial impacts would be climate value at risk. The climate risk and financial impact assessments assist real estate owners, or investors in prioritising assets or portfolios deemed vulnerable to climate-related risks and developing corresponding climate mitigation and adaptation measures. Nevertheless, landlords and real estate fund managers may utilise the results of the assessments in preparing their ESG or TCFD disclosures.

5. Conclusion

The findings of this research study provide valuable insights into the relationship between sustainability provisions and leasing performance in 181 representative office buildings in Hong Kong. The sustainability analysis and regression modelling results indicate that ESG provisions significantly impact rental levels, contributing up to a **17.1% premium**.

The study also highlights investment priorities, such as providing EV charging infrastructure, renewable energy, and resilience to extreme climate conditions. These provisions reduce greenhouse gas emissions and minimise the physical risks associated with climate change. Other investment priorities include art and culture integration, in-house amenities, and security access, which promote user well-being.

BEAM Plus, LEED, and WELL are sustainable certification standards widely adopted in the Hong Kong market to demonstrate corporate commitment to sustainability. More recently, WiredScore and SmartScore have emerged as certifications specifically focused on smart buildings. As

more landlords invest in sustainable certifications, they could become an ESG screening criterion to avoid **“brown discounts.”**

Beyond technical sustainability provisions and certifications, the study highlights the growing adoption of green leases or pledges. Tenant engagement encompasses data sharing on energy and water usage, waste generation and recycling, fit-out guides, and reward systems. These initiatives foster collaboration between landlords and tenants in achieving sustainable outcomes.

This research study summarises the significance of sustainability provisions in office buildings, indicating tangible rental premium benefits. Investors can consider implementing a range of sustainability features, as mentioned in this report, to enhance the performance and market competitiveness of office buildings. These results provide generic recommendations for ESG provisions, and a **tailor-made ESG enhancement plan** should be discussed with consultants to maximise the green rental premium of the asset.



Limitations

- The study was based on correlation to rentals. The decision-making process for the ESG enhancement plan should consider the capital costs of each ESG parameter.
- This provides an overview of the investment ESG priorities for each parameter. The ESG scores of the assets could shift depending on the materiality of each parameter to the client's business. The mechanism should be tailor-made at the detailed stage.
- Multi-collinearity exists among the variables (components of sustainability provisions), indicating that they are intercorrelated. Changes in one variable are associated with shifts in another. This may reduce the power of the model to explain or determine the total effect and coefficient estimates of the variables, even if they are statistically significant.

Databank - The numbers behind this report

Environmental Parameter across All Districts in Hong Kong							
%	All districts	Central / Admiralty/ Sheung Wan	Wanchai / Causeway Bay	Island East	Kowloon Central	Kowloon East	Kowloon West
E1: BEAM Plus building accreditation							
Platinum	29.28	34.78	33.33	62.5	24	21.05	0
Gold	1.66	0	0	0	0	2.63	8.33
Bronze or Silver	0.55	0	0	4.17	0	0	0
No	68.51	65.22	66.67	33.33	76	76.32	91.67
E2: LEED building accreditation							
Platinum	11.6	17.39	29.17	8.33	4	7.89	0
Gold	1.66	0	8.33	0	0	2.63	0
Bronze or Silver	0	0	0	0	0	0	0
No	86.74	82.61	62.5	91.67	96	89.47	100
E3: Renewable energy							
Yes, and contribute over 3% of total building energy	0.55	0	0	4.17	0	0	0
Yes, and contribute over 1% of total building energy	6.63	6.52	4.17	8.33	0	5.26	8.33
Yes, with renewable energy	13.26	10.87	25	20.83	0	10.53	8.33
No	79.56	82.61	70.83	66.67	84	84.21	83.34
E4: EV charging infrastructure							
Yes, with over 90% of EV charging point	2.21	2.17	0	0	0	7.89	0
Yes, with over 50% of EV charging point	1.1	0	0	0	0	2.63	4.17
Yes, with EV charging point	59.12	50	79.17	62.5	76	44.74	58.33
No	37.57	47.83	20.83	37.5	24	44.74	37.5
E5: Energy consumption monitors							
Yes	33.7	45.65	79.17	62.5	4	5.26	12.5
No	66.3	54.35	20.83	37.5	96	94.74	87.5
E6: Water reduction provisions & recycling systems							
Yes	47.51	63.04	75	75	20	18.42	37.5
No	52.49	36.96	25	25	80	81.58	62.5
E7: Water consumption monitors							
Yes	25.97	36.96	37.5	66.67	4	2.63	12.5
No	74.03	63.04	62.5	33.33	96	97.37	87.5
E8: Waste data collection							
Yes	25.41	39.13	41.67	66.67	0	5.26	0
No	74.59	60.87	58.33	33.33	100	94.74	100
E9: Resilience to extreme climate conditions							
Yes	55.8	67.39	58.33	50	64	50	37.5
No	44.2	32.61	41.67	50	36	50	62.5
E10: Biodiversity and conservation							
Yes	32.04	15.22	16.67	20.83	28	55.26	58.33
No	67.96	84.78	83.33	79.17	72	44.74	41.67

Social Parameter across All Districts in Hong Kong							
%	All districts	Central / Admiralty / Sheung Wan	Wanchai / Causeway Bay	Island East	Kowloon Central	Kowloon East	Kowloon West
S1: WELL building accreditation							
Platinum	6.08	4.35	0	20.83	0	10.53	0
Gold	1.11	0	0	4.17	0	2.63	0
Bronze, Silver or Health & Safety Rating (HSR)	14.36	32.61	16.67	4.17	12	5.26	4.17
No	78.45	63.04	83.33	70.83	88	81.58	95.83
S2: Indoor air quality monitoring system							
Yes	39.23	50	37.5	62.5	24	39.47	12.5
No	60.77	50	62.5	37.5	76	60.53	87.5
S3: Public transport walkability							
Yes	90.61	100	100	100	88	76.32	20.83
No	9.39	0	0	0	12	23.68	79.17
S4: Neighbourhood amenities							
Yes	90.06	100	83.33	100	96	73.68	87.5
No	9.94	0	16.67	0	4	26.32	12.5
S5: Open space							
Yes	54.7	54.35	33.33	70.83	72	47.37	54.17
No	45.3	45.65	66.67	29.17	28	52.63	45.83
S6: In-house amenities							
Yes	61.33	84.78	58.33	54.17	72	39.47	50
No	38.67	15.22	41.67	45.83	28	60.53	50
S7: Art and Culture							
Yes	35.91	43.48	37.5	50	52	7.89	33.33
No	64.09	56.52	62.5	50	48	92.11	66.67

Governance Parameter across All Districts in Hong Kong							
%	All districts	Central / Admiralty / Sheung Wan	Wanchai / Causeway Bay	Island East	Kowloon Central	Kowloon East	Kowloon West
G1: Building management & smart control systems							
Yes	45.86	56.52	41.67	62.5	20	47.37	37.5
No	54.14	43.48	58.33	37.5	80	52.63	62.5
G2: Corporate carbon reduction targets							
Yes	70.72	71.74	79.17	62.5	96	55.26	66.67
No	29.28	28.26	20.83	37.5	4	44.74	33.33
G3: Transparent ESG reporting							
Yes	77.35	76.09	87.5	83.33	96	63.16	66.67
No	22.65	23.91	12.5	16.67	4	36.84	33.33
G4: Security access							
Yes	26.52	32.61	16.67	25	44	26.32	8.33
No	73.48	67.39	83.33	75	56	73.68	91.67
G5: Green pledge and green fit-out guide							
Yes	54.7	43.48	33.33	45.83	96	55.26	62.5
No	45.3	56.52	66.67	54.17	4	44.74	37.5
G6: Tenant engagement programme							
Yes	46.96	43.48	33.33	50	68	42.11	50
No	53.04	56.52	66.67	50	32	57.89	50
G7: WiredScore and Smart Score building accreditation							
Yes	10.5	8.7	8.33	25	8	13.16	0
No	89.5	91.3	91.67	75	92	86.84	100

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