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The Real Estate New Normal: Grappling with the S in ESG

by Nick French | Oct 14, 2024

The only constant is change, everything else is a variable" Heraclitus, 535 BC.

Introduction
The mantra above is one of my favourite quotes which I have referenced throughout my real estate career. In that time, I have seen changes in occupier behaviour, changes in leases, changes in building techniques, changes in investor risk profile and unimagined changes in technology that has influenced how we work and live.

Now, much of the escalation in change over my life time has come in my latter years; the COVID pandemic acted as a huge economic and technological catalyst, while new trends in shopping, work patterns and increased leisure activities have happened almost overnight. Indeed, at the beginning of COVID I was invited to forecast the world that we would inherit as we moved out of restrictions and returned to "normal".

This is what I wrote in August 2020:

"New jobs were being created, businesses were rising phoenix-like from the flames and the world was, slowly, returning to the normal of last year. The real estate market was reacting. Logistics was now king for a population that had learnt to shop in their castles. High streets were changing and returning to places of living with failing retailers giving way to new homes and new communities. Offices were contracting as the stay-at-home technologies were now tried and tested and working"

Even then, it was clear that the world was moving to a "new normal".

A label by any other name
One of the other big changes in my lifetime is the need to give everything a label; normal can't simply change, it has to be "new". But, in our capitalist society, the reality is real estate, like every other factor of production, reacts to the market.
Ricardian land theory simply states that it is what you can do with the land that determines it value. And that is as true in this "new normal" as it was pre-pandemic. Markets change and the use of property reacts. That is what happened during COVID and the ripples of that shock are still reverberating in all sectors today.
In the office sector, working at home has become acceptable for many businesses; some firms are fighting it as they feel that productivity is higher within the interactional space of the office. Edicts to return to work are now becoming more common. The market is still finding its new balance.

Likewise, in retailing, the over-supply of shops and the convenience and success of online shopping has impacted many high streets and shopping centres. That doesn't mean that all are failing but where shops are still being seen as a destination—such as the rejuvenated Oxford Street in London—rents are now rebased to a level that reflects the worth of that space to the retailer.

But where shops have closed, high streets will continue to suffer until planners and local authorities accept that a reversion to residential with more food and beverage outlets will revitalise towns and cities. That market too is still searching for its new balance.

I could go on with more examples in the hospitality sector, the logistics sector, the industrial sector and the leisure sector, but the above illustrates the point that I am trying to make and that is that property reacts to a change in behaviour. Yes, there are outside influences that restrict or direct those changes but ultimately if we understand behaviour, we can understand how property markets will adapt and transform.

Environment, Social and Governance (ESG)
The nature of this dissertation is to try to bring together a couple of themes. The need to have labels for everything and the unrelenting continuous change in all markets.
In real estate, and in business in general, probably the most important initiative at the moment relates to what is now referenced as "Environment, Social and Governance", or ESG for short.

Within the property world, once this was referred to as "sustainability" but the complexities of all the issues involved and the need for it to be more all-encompassing business perspective led to the change in the label. But why are labels important?
In education, the argument is that by naming a condition or aspiration, you provide the stakeholders with tools that can help cope with the condition or provide a pathway to achievement.

ESG does that for the property world. ESG does that for the business world. ESG does that, hopefully, for the planet. The grouping captures all issues that relate to the possibility of mitigating the negative effects of climate change, all issues relating to the prudent use of natural resources and provides a framework to ensure that businesses operate in a financial, ethical and egalitarian way. It also provides a focus for governments to introduce restrictions on the use of inefficient properties.

For property it we are using labels to return to basics. We need a way to ensure that buildings are used prudently and sustainably. Once this happened without any labels. If you look at the design and construction of traditional houses in all locations, they used to be built to utilise local materials and to be cool or warm depending upon the prevailing climate. Today that would need lots of labels to achieve the same.

The S in ESG
The current label entertaining today's zeitgeist is the S in ESG. Companies are concentrating upon the need to match working practices and working spaces to accommodate and encourage the best workers to work for them. This may be 100% home working or a blend of office and home.
However, where firms want 100% office working, they are recognising that the space being offered has to be enticing; more space, more services within the building; more social areas and more flexibility. In simple terms, office occupiers, shop workers, warehouse personnel all need more than just the enticement of a pay check; they want a good work/life balance and they want to spend their time in a space that "works" for them.

And so we have this new label, "The S". But if you break it back to basics, it is just a continuation of markets and properties adapting to change. This would be happening regardless of what we call it. Markets are driven by human behaviour, so if we understand how behaviour changes, then you can match the property offer to the current market demand.

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