

## The Importance of ESG in the Real Estate Investments

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### Abstract

*ESG factors—environmental, social, and governance considerations—have gained growing significance within the real estate industry. This study explores the multifaceted impact of ESG considerations on real estate investments and practices. It delves into the evolving investor, consumer, and regulatory landscape, shedding light on the growing importance of sustainable and socially responsible strategies. It also examines the benefits associated with embracing ESG principles in real estate, encompassing enhanced risk management, improved long-term performance, increased stakeholder engagement, and alignment with global sustainability objectives. Furthermore, it discusses the challenges and opportunities inherent in implementing ESG frameworks within the diverse realms of property development, management, and investment. Through an analysis of current trends, regulatory frameworks, and industry practices, this research provides insights into the transformative potential of ESG integration for fostering resilient, socially conscious, and economically viable real estate ventures.*

**Key words:** real estate, social responsibility, governance, sustainability, environmental factors

**J.E.L. classification:** R00, M14, G34, Q56, F64

### 1. Introduction

Real estate developers are increasingly paying attention to environmental, social, and governance (ESG) elements within projects, and the delivery of green buildings is just one component of emphasizing sustainability principles. Focus on energy efficiency and carbon emissions will become a priority against the backdrop of the European Union's policy aiming for carbon neutrality by 2050, which will also influence all new real estate developments.

ESG (Environmental, Social, Governance) criteria in real estate refer to a set of standards that investors, stakeholders, and developers use to assess a property's sustainability and ethical impact. These criteria have gained prominence in the real estate industry as they encompass broader considerations beyond mere financial returns.

Sustainable buildings are designed to be more resilient to environmental changes, such as extreme weather events, and are often adaptable to changing technological and societal demands.

Overall, sustainability in real estate investments not only aligns with global environmental goals but also offers tangible financial benefits, reduced risk exposure, and increased attractiveness to tenants and investors in a rapidly evolving market (Eng, 2023).

The goal of this research is to uncover how extensively investors integrate ESG criteria into their real estate businesses and to examine the benefits of this adoption. This includes advantages not only for the investors but also for fostering sustainable development within the region or country. Investors and stakeholders within the real estate market recognize both the significance and the advantages of integrating ESG factors into the industry as it is shown in our research. Companies started to implement the ESG strategy and make reports about its importance.

In summary, ESG in real estate goes beyond conventional metrics, prioritizing sustainability, social responsibility, and ethical governance to create properties that are not just financially lucrative but also environmentally and socially conscious.

## **2. Literature review**

Environmental factors include aspects like energy efficiency, use of renewable energy, waste management, water conservation, and overall environmental impact. Green building certifications, such as LEED (Leadership in Energy and Environmental Design) or BREEAM (Building Research Establishment Environmental Assessment Method), are often pursued to showcase a property's eco-friendly attributes.

Social impact evaluates the property's impact on communities, occupants, and society at large. Factors might include affordable housing, tenant health and safety, diversity and inclusion policies, community engagement, and the overall well-being of individuals associated with the property (Newell & Marzuki, 2022).

Governance considerations focus on the transparency, accountability, and ethical behavior of real estate companies. This includes factors such as board diversity, executive compensation, adherence to regulations, and anti-corruption policies (Newell, 2023).

Integrating ESG principles into real estate projects can yield various benefits such as risk mitigation, enhanced value and long-term sustainability.

Therefore, sustainability has become a critical factor in real estate investments. Sustainable practices in real estate can mitigate various risks (Warren-Myeres, 2023), including regulatory risks (compliance with changing environmental standards), physical risks (impacts of climate change on property), and reputational risks (negative public perception due to unsustainable practices).

Moreover, properties that integrate sustainability features tend to have higher market value and can command premium pricing. Energy-efficient buildings, for example, often have lower operating costs, which can attract tenants and increase property value.

There's a growing demand for sustainable and environmentally friendly properties. Tenants, investors, and consumers increasingly prefer buildings that prioritize energy efficiency, green spaces, eco-friendly materials, and reduced environmental impact. Still, the autonomy of space users and their ability to act within smart real estate settings face challenges due to the imposition of algorithmic governance on their interactions within smart spaces (Lecomte, 2023)

Sustainable buildings often boast lower utility costs due to energy-saving features like efficient HVAC systems, LED lighting, and renewable energy sources. Over time, these savings contribute significantly to the property's financial performance (Cajias et al., 2011).

As environmental regulations evolve and become stricter, sustainable buildings are better positioned to comply with these regulations. Investing in sustainable features helps future-proof properties against potential regulatory changes. Regulatory bodies, such as the European Union and other governments globally, are implementing policies to encourage or enforce ESG compliance in real estate. This creates a stronger incentive for developers and investors to align with these principles, not just for ethical reasons but also for long-term economic viability.

## **3. The ESG factors in the real estate market – Evidence from Romania**

The real estate market in Romania has been an area of interest and growth, particularly in urban centers like Bucharest, Cluj-Napoca, Timișoara, Constanța and Iași. In recent years, there has been increased attention to integrating ESG principles into real estate development across the country.

Romania has seen a rise in green building initiatives, with a growing number of developers focusing on constructing environmentally friendly buildings. This includes obtaining certifications like BREEAM or LEED for their projects, showcasing a commitment to sustainability. Developers are also exploring renewable energy sources and energy-efficient designs in their buildings to reduce the carbon footprint. This aligns with the broader EU goals of achieving carbon neutrality by 2050. The Romanian real estate market has been influenced by EU directives and policies emphasizing sustainability. This has led to increased attention to ESG factors as part of regulatory compliance and a means of attracting investors interested in sustainable projects. There's growing

interest among investors in ESG-aligned properties. Institutional investors, in particular, are increasingly considering ESG factors in their investment decisions, prompting developers to integrate these principles into their projects to attract funding. There's a developing awareness among consumers and businesses regarding the benefits of ESG-focused real estate. This awareness, coupled with educational initiatives and campaigns, contributes to the demand for sustainable properties.

In the realm of ESG considerations, developers must not only focus on constructing environmentally sustainable buildings but also take into account how these properties affect the community, including aspects like diversity. This approach is already being adopted in the local market, particularly with mixed-use or commercial projects designed to serve the specific needs of nearby communities. For example, a developer investing in road infrastructure, parking facilities, or green spaces actively contributes to enhancing the overall environment of the project's location.

In a survey by PwC Romania, just 30% of companies surveyed reported adopting ESG sustainability standards, with 63% admitting they lack familiarity. When questioned about integrating fiscal policies into their ESG strategies, 26% confirmed doing so, 5% denied it, and a majority (68%) either lacked these strategies or were unaware of their implementation. (Borbely & Chelaru, 2022).

While progress is evident, challenges persist, including the need for greater awareness, investment in sustainable technologies, and alignment with stricter ESG regulations. However, these challenges also present opportunities for innovation, partnerships, and market differentiation for developers.

Overall, the Romanian real estate market is witnessing a gradual shift towards ESG integration, driven by a mix of regulatory pressures, investor preferences, and a growing awareness of sustainability issues. This transition presents opportunities for stakeholders to contribute to a more sustainable built environment while meeting the evolving demands of the market.

#### **4. Research methodology**

Analyzing ESG (Environmental, Social, and Governance) factors in the real estate sector aims to understand the influence and implementation of sustainability practices, community engagement, and corporate governance within real estate investments. This analysis typically explores the impact of ESG criteria on property values, tenant satisfaction, regulatory compliance, and overall investment performance. The goal is to provide insights into how these factors affect decision-making and outcomes in the real estate market.

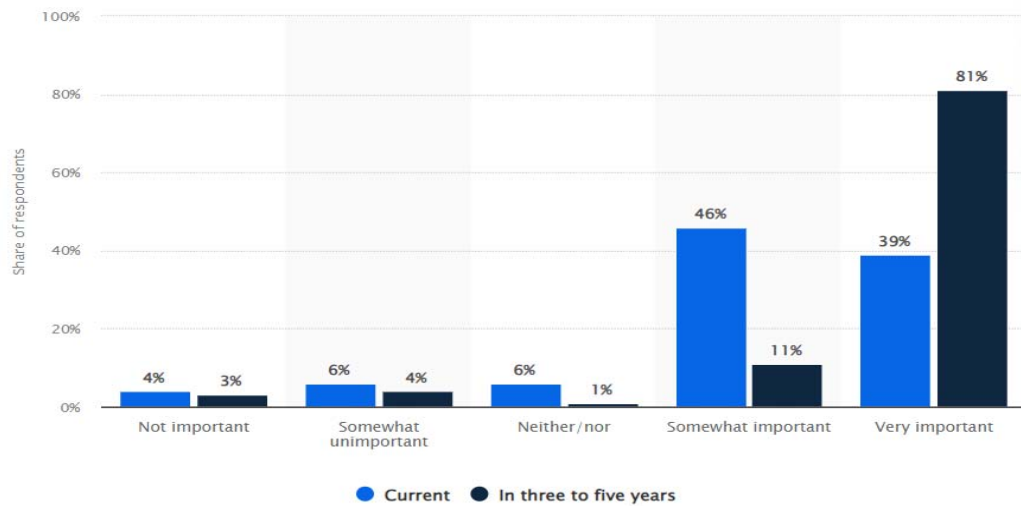
The study will analyse real estate investors' opinion on the current and future importance of ESG criteria, benefits resulting from environmental, social, and governance (ESG) applied in the real estate sector. The assessment of real estate investors' perspectives on various environmental, social, and governance (ESG) measures is crucial for pinpointing elements that hold significant importance in achieving planetary goals and the United Nations Development Goals.

Our research on ESG in real estate, like any study, faces certain limitations such as: data availability and quality. ESG criteria can be subjective, leading to variations in how different researchers or investors interpret and measure these factors. Lack of standardized metrics can impede consistent evaluation. Also, investors or real estate companies might selectively report positive ESG practices while downplaying or omitting negative aspects, leading to a biased view of their ESG performance.

While a relatively novel area for researchers, ESG in real estate holds significant importance and is poised to become a crucial strategy for companies aiming to maintain competitiveness in the market. Additionally, aligning with the new regulations of the EU will be imperative for these companies in the near future.

According to Figure 1, 39% of respondents consider the ESG strategy highly significant for the current state of the real estate sector. However, predictions suggest that this figure will escalate to 81% in the future. Currently, 46% of respondents perceive ESG factors as crucial to their business, with only 11% deeming it somewhat important. These figures indicate a future where all investors will prioritize ESG factors to maintain competitiveness in the market and bolster their profit.

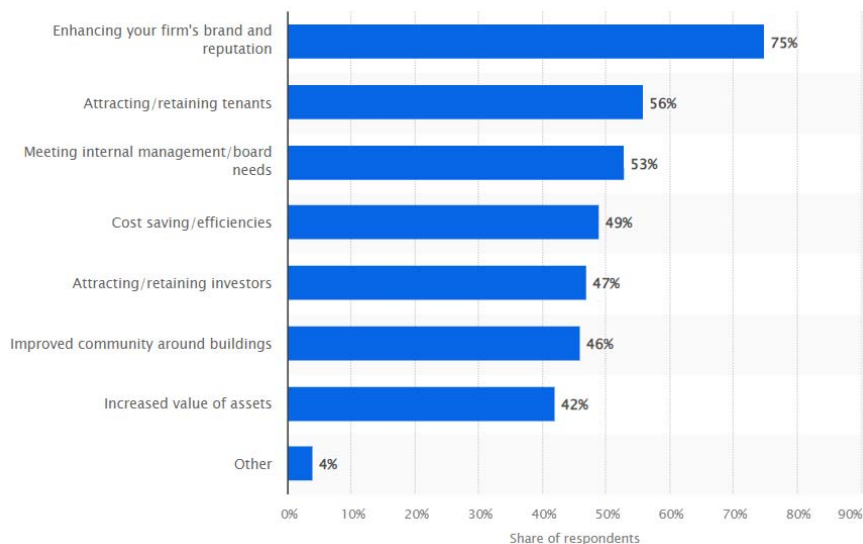
Figure no.1 Real estate investors' opinion on the current and future importance of environmental, social, and governance (ESG) criteria worldwide as of 2022



Source: Statista, 2022, <https://www.statista.com/statistics/1320678/esg-criteria-importance-real-estate-investment/>

Nevertheless, ESG factors bring lots of benefits for developers and real estate sector as investors reported (figure no.2): 75% declared that implementing ESG strategy enhanced their firm's brand and reputation, 56% of the investors considered that they attract/retained more tenants, 53% found ESG connected to their internal management/board needs in a positive way. Other significant benefits are cost savings/efficiencies, attracting/retaining investors, improved community around buildings and increased value of assets.

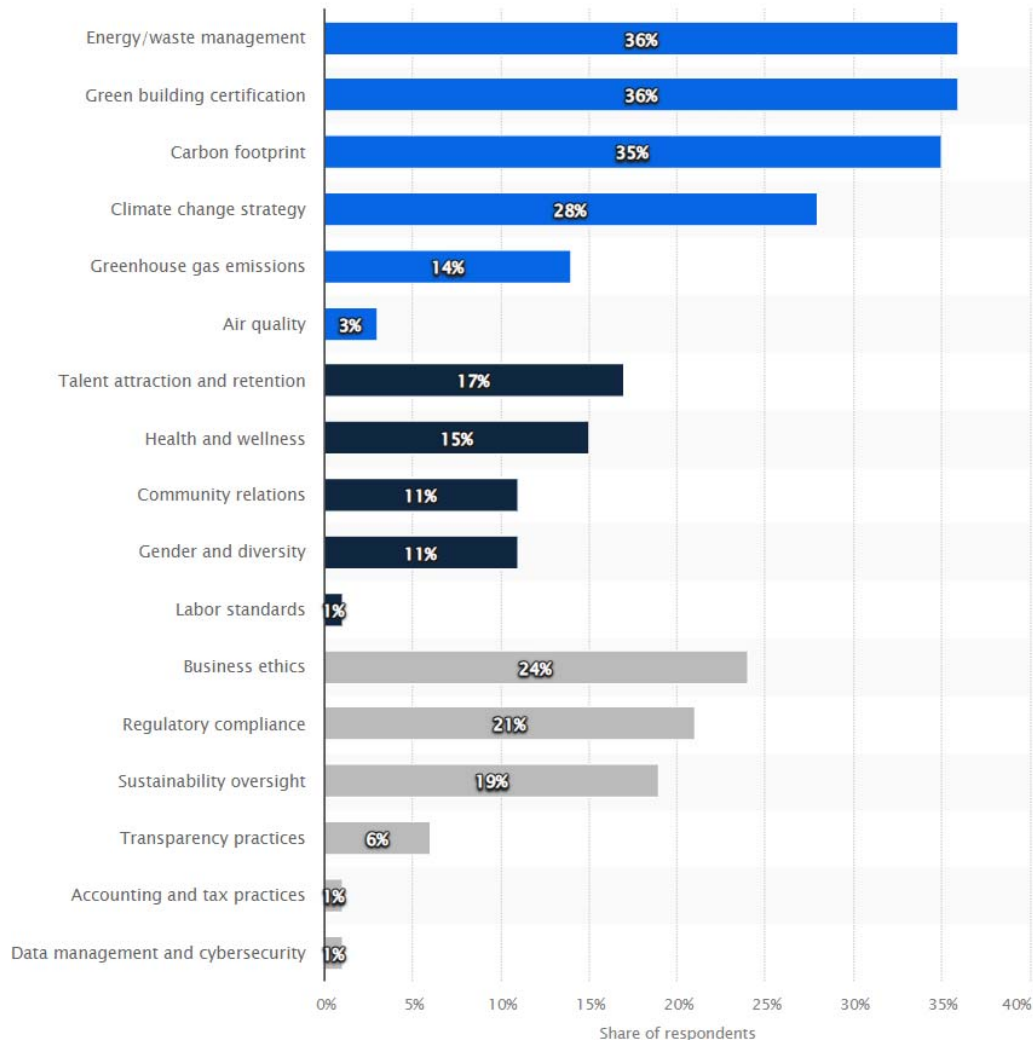
Figure no.2 Share of real estate investors who report different benefits resulting from environmental, social, and governance (ESG) measures worldwide as of 2022



Source: Statista, 2022, <https://www.statista.com/statistics/1329899/esg-measures-benefits-real-estate-investment-globally/>

There's a growing interest among real estate investors in Environmental, Social, and Governance (ESG) factors. These considerations have gained significance as investors increasingly recognize the impact ESG can have on long-term sustainability, risk management, and overall performance within the real estate sector.

Figure no. 3 Real estate investors' opinion on the importance of different environmental, social, and governance (ESG) measures worldwide in 2022



Source: Statista Research Department, 2023, <https://www.statista.com/statistics/1320678/esg-criteria-importance-real-estate-investment/>

In a March 2022 survey (Figure no. 3), environmental sustainability emerged as the primary ESG criterion among real estate investors. One-third of respondents highlighted energy or waste management, green building certification, and carbon footprint as pivotal factors. Within social sustainability, talent attraction and retention garnered the highest consideration, noted as important by 17 percent of respondents. Meanwhile, governance criteria saw business ethics, regulatory compliance, and sustainability oversight ranking prominently. According to survey results, already established ESG measures included corporate sustainability reporting and net zero planning, emerging as some of the most popular among respondents.

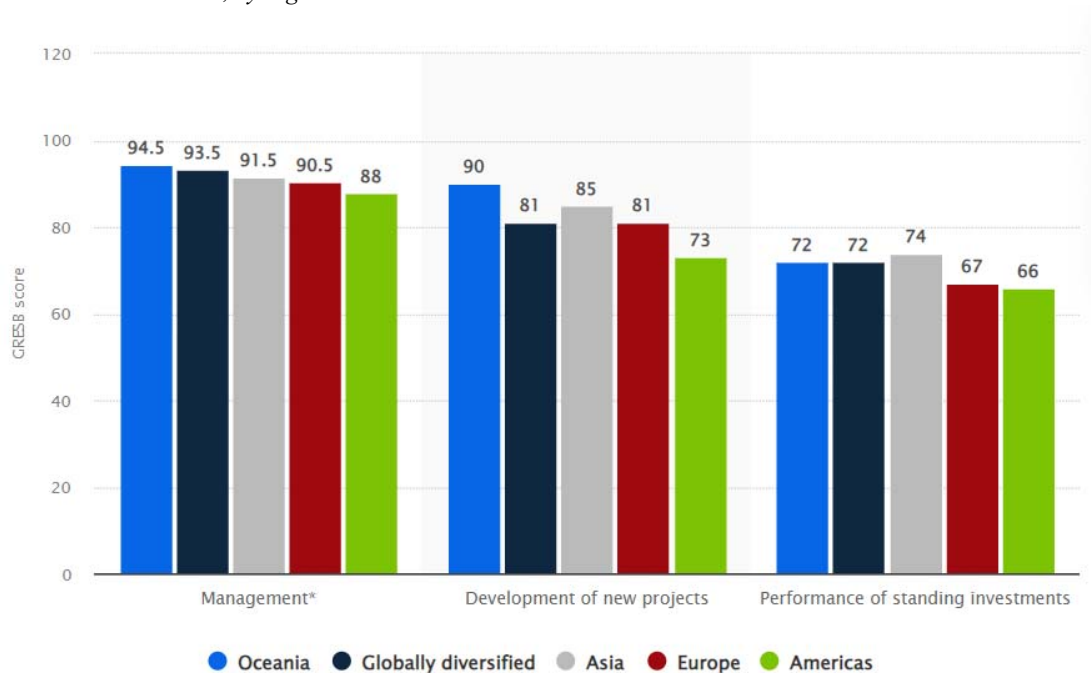
A 2022 Knight Frank study involving 400 UK corporate occupants highlighted their stance on sustainability and ESG. It revealed a lack of consensus regarding the real estate sector's potential role in reducing carbon emissions. Particularly noteworthy was the disparity between intent and

action among businesses prioritizing ESG principles. Among surveyed corporations, 40% had established net-zero carbon objectives, with 77% of this group setting an ambitious target of achieving this by 2030 – a goal within one real estate cycle. However, only 16% of respondents felt that their commitment to achieving net-zero carbon significantly influenced their real estate decision-making processes. Additionally, nearly 60% had less than 10% of their global portfolios consisting of accredited buildings.

All in all, companies can benefit from implementing ESG strategies when developing smart buildings. For example, the implementation of smart, environmentally conscious buildings has the potential to decrease water consumption by up to 30%, energy usage by 40%, and overall building maintenance costs by 10% to 30% (Apanaviciene et al., 2000).

Studies further indicate that these smart-green buildings could yield a lease value increase of 11.8%, accompanied by higher sales values ranging between 5% and 35% (Hatcher, 2021).

Figure no.4 Global Real Estate Sustainability Benchmark (GRESB) score of real estate companies worldwide in 2023, by region



Source: Statista Research Department, 2023 <https://www.statista.com/statistics/1414641/gresb-score-real-estate-worldwide-by-region/>

In 2023, real estate firms worldwide demonstrated exceptional proficiency in sustainable management practices, as per GRESB data. However, across all regions, standing investments showed the weakest sustainability performance. Notably, Asia led with the highest score of 74 out of 100 (figure no. 4). GRESB is an industry-driven entity, assesses, verifies, rates, and compares ESG performance. ESG benchmarking has gained traction within the global real estate sector, with the participation of companies in GRESB steadily rising since 2013.

## 5. Findings

The ESG trends in the Real Estate sector are: green building and eco-efficient practices: planning and constructing methods aimed at minimizing adverse environmental effects, extending across supply chains and enhancing the eco-efficiency of buildings.

Creating community partnerships: real estate companies should engage local communities from the project's inception to reduce negative impacts, disruptions, and explore how they can contribute to community development, local economic support: prioritizing sustainable supply chains can set

real estate firms apart, while supporting local partners can create positive environmental and communal impacts. Safety measures: real estate entities should prioritize employee and public safety during construction phases and ensure the quality and safety of completed assets, labor standards and social responsibility: given its significant employment impact, the real estate sector should address labor conditions and human rights issues, climate resilience: real estate entities should develop the capacity to anticipate, prepare for, and respond to climate change-related risks affecting both employees and users, such as rising temperatures, sea-level rise, flooding, and more.

The real estate sector's increased involvement with governmental and public entities may necessitate specific attention to engagement levels and effective communication.

## 6. Conclusions

Cities and regions might implement policies promoting smart growth, mixed-use developments, and transit-oriented designs to reduce environmental impact and encourage social inclusivity (Robinson & McIntosh, 2022). Many regions enforce building codes or offer certifications encouraging energy efficiency, sustainable materials, and environmentally friendly construction practices.

Institutional investors, shareholders, and stakeholders are increasingly demanding ESG integration, influencing company policies and practices.

Real estate firms must adjust to evolving investor, consumer, and commercial demands, securing approval for their business practices and procedures from stakeholders and the public. A comprehensive approach to ESG is necessary to build a resilient "ESG-proof" enterprise, potentially enhancing talent attraction, bolstering reputation, and securing the social license to operate.

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