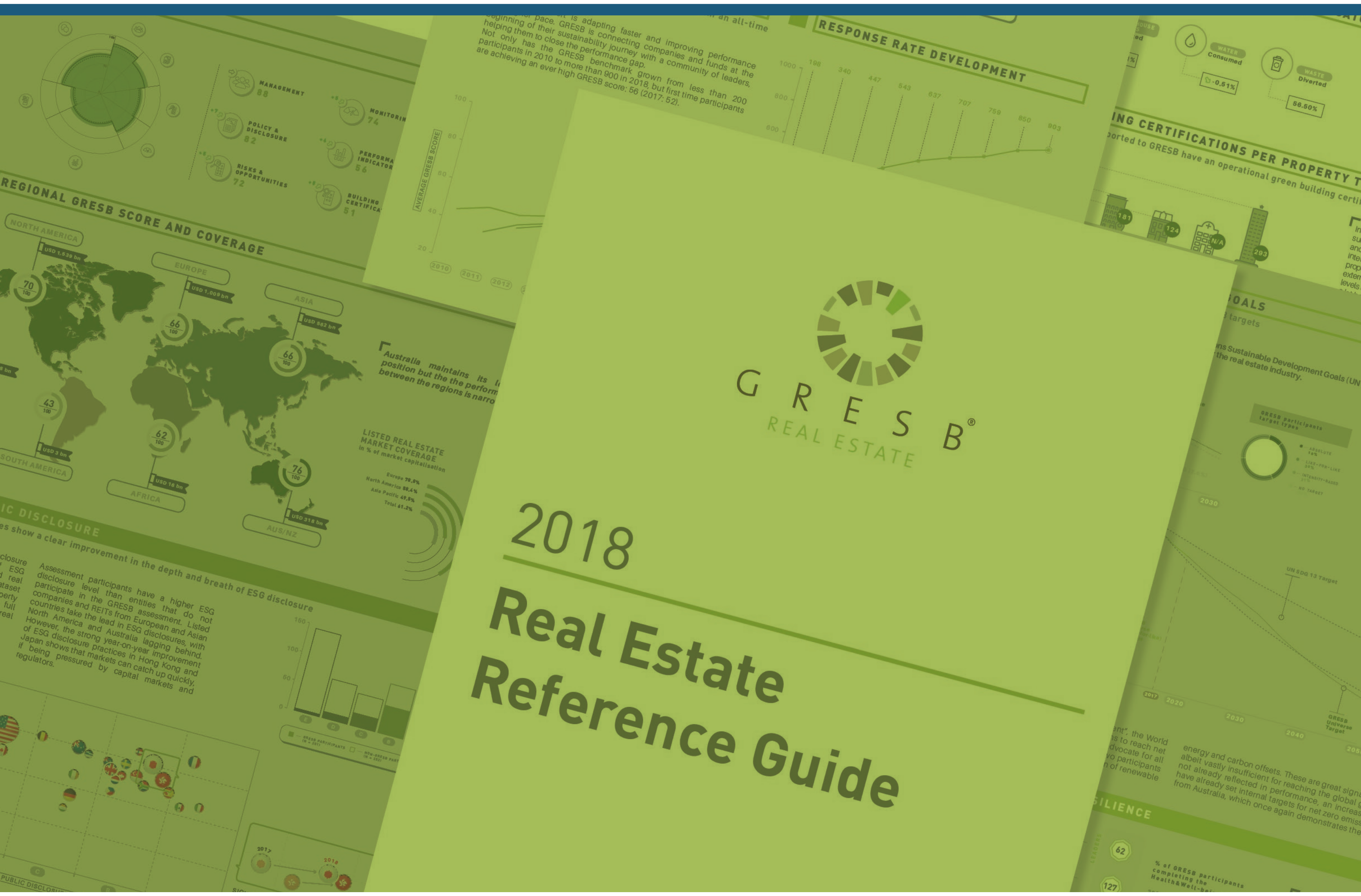
INDUSTRY INSIGHT

BBP BETTER BUILDINGS PARTNERSHIP



2018 GRESB SURVEY CONSULTATION RESPONSE

DECEMBER 2018

Introduction

The Better Buildings Partnership (BBP) is a strong advocate of GRESB. Since its introduction, the GRESB surveys have raised Environmental, Social and Governance (ESG) considerations up the agenda of the real estate investment market on a global scale and at an unprecedented rate. It is one of the few ESG initiatives that has truly transformed the way the whole real estate industry approaches sustainability.

The past 12-months has seen GRESB continue to drive market change. Participants' performance within the GRESB surveys now has a direct impact on the way in which ESG policies and strategies are being implemented, and crucially, the way in which investors are making investment decisions.

Whilst this is a welcome response from the market, it brings about significant risks in which GRESB must stand accountable against. Namely, its ability to fairly reflect ESG performance, the transparency and rigor of scoring, and encouraging the behaviours from both investors and participants that will result in improved ESG performance.

As the GRESB surveys evolve, the BBP feels there are opportunities for continued development and improvement, both in terms of the value that it provides stakeholders, as well as the level of trust placed on the outputs. In this light, BBP members who participated in the 2018 Real Estate and Debt surveys have provided the following recommendations for GRESB's consideration as part of its 2018 consultation process, which it is hoped are viewed in a positive and constructive light.

Real Estate Survey Recommendations

Transparency

RECOMMENDATION 1

Undertake a review of the current validation process

An open and transparent data validation process is crucial for GRESB to remain a benchmark of quality and credibility that the industry can trust. The BBP welcomes the changes and improvements that GRESB have made to the validation process over the past few years. The rapid level of change that has been implemented is fully commended. However, with the level of weight given to GRESB scores by investors, the validation process has become one of the most critical elements of the Real Estate Survey and in 2018, members have found its practical application to be insufficient in providing the level of trust they would expect. Specific concerns include the:

- **Third party review of uploaded documentation and the simplicity in which it is undertaken.** Completion of the Survey requires participants to upload an extensive evidence base into the online portal. The BBP is sympathetic to the fact that, due to the sheer volume of evidence required, it is impossible for all the evidence to be reviewed in detail. However, the approach has resulted in inconsistencies within the review process. Members have experienced instances where evidence, which had been accepted in previous years, was declined this year; identical evidence has been accepted for some funds but not others; evidence has not been accepted even though the detail is contained within the evidence, but instead informed that the evidence did not contain the "required wording". Such an experience undermines the very requirement of uploading evidence if it starts to become a tick-box exercise, where wording in the evidence simply needs to mirror the wording stated within Survey questions.

- **Inconsistent approval of clarifications within the comments box.** Members have noted that there is inconsistency in the way clarifications provided within comment boxes are approved, as instances have occurred where identical explanations have been approved for one member but not the other. It would be useful to understand if there is an internal process amongst assessors to centrally record accepted explanations to ensure consistency in the approvals process.

- **Lack of clarity regarding the governance process for dealing with validation issues/queries and disputes.** Whilst the 2018 Real Estate Assessment Reference Guide clearly sets out the validation levels that exist, there is a lack of information that explains the process for dealing with inquiries and disputes, and how such queries are managed and by whom. Further clarity and transparency of this process is requested to support participants in completing Survey submissions.

- **Lack of public feedback from Validation Plus and Validation Interviews.** Members that participated within the full suite of validation layers have highlighted that the feedback is informative and helpful in providing clarity regarding how certain elements of the Survey should be completed. It is felt that this feedback should be shared with all participants to allow them to benefit and help develop consistency in approaches.

It is felt a review of the current validation process should be undertaken to consider the level of evidence required, how evidence can be reviewed in a robust manor, and how participants can have the opportunity to correct errors or resubmit evidence that would be rejected before final results are published. It is understood that GRESB is aware of the challenges and is proposing to continue to refine the validation process via the development of a new Data Quality Standard. The BBP welcomes such developments and would be keen to understand the planned developments in greater detail.

RECOMMENDATION 2

Provide an ability to communicate challenged scoring

GRESB has previously communicated that participants do not have the option for scores to be corrected within the online portal, but will provide corrected scores in a separate report. It appears odd that the benchmark for any given year cannot be 'fixed' to ensure it remains static and individual participant scores can be corrected. However, assuming participant scores cannot be retrospectively amended, where there is disagreement between GRESB and a participant over how scores have been calculated (e.g. disagreement in the acceptance of evidence), members have suggested that it would be useful for this to be flagged in some capacity within the participant's Scorecard so investors are aware of the fact.

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RECOMMENDATION 3

Publish investor guidance on how to interpret participants' results

Extensive guidance is provided within the resources section of the GRESB website, which acts as a valuable resource to participants in helping them complete the various surveys, understand scoring and interpret results. However, it is noted that there is very little guidance targeted at investors.

BBP members have noted that they are increasingly hosting one-to-one meetings with investors to help explain GRESB results and articulate nuances in scoring based on portfolio types, changes in peer groups etc., as well as how changes to the Survey between years can affect scoring.

The BBP believes there is a clear role GRESB can play in supporting investors in their understanding of how the Survey scoring works and how results should be most appropriately interpreted. If this was made publicly available, it would also support participants when engaging in dialogue with their investors.

RECOMMENDATION 4

Ensure relevant participant communications are clearly published in advance of the Survey closing

GRESB has taken great strides in improving the level and granularity of guidance that is published online for participants. However, members have noted that there are still some forms of communication that would be useful whilst the Survey was still open. Two specific examples include:

- Answers to questions that were raised during the submission window that highlight gaps in the Survey guidance.

- The scoring document to fully help participants understand how questions are scored.

RECOMMENDATION 5

Provide the ability to separately state the fund/company investment strategy classification in addition to the automated peer group classification

Members have noted that the automated peer group classification does not always align with a fund's strategy. In addition, peer groupings can change between years based on the acquisition and disposal strategies of participating entities. This can be frustrating for fund managers who cannot compare themselves to funds they consider as peers in terms of their investment strategy, as well as potentially being confusing for investors.

The additional ability for participants to be able to state and be compared against their own selected investment strategy would help alleviate some of the frustrations that result from an automated peer group classification. It should be noted that this issue predominately relates to fund management companies rather than the property companies who participate in the Survey.

RECOMMENDATION 6

Remove the Green Star as a rating to avoid confusion

The GRESB Real Estate Survey currently uses two parallel star-based rating systems: the Green Star and the 5-star GRESB rating. The BBP previously advocated the move to a 5-star scale system and welcomed the introduction of the GRESB rating. However, it was also recommended that only one primary rating KPI is used to assess performance and the continued use of two only increases confusion amongst stakeholders.

Materiality

RECOMMENDATION 1

Ensure that scoring is not unfairly impacted as a direct result of an entity's level of management control

The 2018 Real Estate Survey asks for information where the answers, and resulting performance, are significantly impacted by the degree of management control a participant has over its properties. Specifically, triple net and full repairing and insuring (NNN/FRI) leases (termed 'indirectly managed' assets within the Survey) where the tenant is responsible for management of the property or those where the tenant directly purchases utilities are penalised based on their ability to provide information. For example, assessing whether FRI/NNN properties have implemented certain measures within a four year period (RO5-RO8); the level of the portfolio that is covered by an EMS, the data management processes in place; the way in which it monitors consumption (ME1-ME5); whether it collects energy, GHG, water and waste consumption (PI1) is penalising this asset class purely on the nature of how that asset is leased and how utilities are purchased, rather than its ESG credentials.

This issue has been repeatedly raised by the BBP over several years. Last year, GRESB responded to this issue stating *"2018 scoring methodology will recognize the differences in data collection capabilities between landlord and tenant controlled areas. This is reflected in the approach on data coverage benchmarking, as well as LFL [like-for-like] benchmarking"*. However, it is unclear, based on the guidance provided with the 2018 Real Estate Reference Guide, as to whether weightings exist for the scoring of 'Managed' and 'Indirectly managed' properties.

With regards to 'Managed Properties', the 2018 Real Estate Reference Guide [p122] states *"The resulting scores are then aggregated to a single score using a weighted mean with weights determined by floor area, except for base building and tenant space for which base building has a static weight of 40% and tenant space has a static weight of 60%. As tenant space has both a landlord obtained, and a tenant obtained section the 60% weight has to be shared between the two which is done based on relative floor area"*. It is unclear if the 'relative floor area' weighting relates to 'Data Coverage' or 'Maximum Coverage' floor area. It would make logical sense if it was based on 'Data Coverage'. However, if it's based on 'Maximum Coverage' then properties where the tenant is responsible for the purchase of utilities or waste management would be adversely affected.

The BBP is also aware that the incentivisation to provide tenant data that is not purchased by the landlord is leading to a perverse behaviour from participants. Property companies/funds are spending significant amounts of resources requesting occupier energy data for NNN/FRI leases or where the occupier directly procures their own energy supply. It is unclear what benefit investors receive from such information when time and effort that could have been better spent focussing on making ESG improvements within their control.

This is not to say that the collection of occupier data should not be rewarded, but that the weighting should not be set in such a way that it unfairly penalises those companies/funds due to the nature of the properties leasing and management arrangements, as well as encourage participants to prioritise the collection of inconsequential data over actual ESG improvements.

If investors increase their behaviour of favouring high scoring companies/funds, then this sets a dangerous precedent of unfairly detracting investments from certain property companies and real estate funds as a result of unintended consequences in the way the Survey is scored, rather than a reflection of ESG performance.

RECOMMENDATION 2

Provide further clarity and guidance on the scope and type of floor areas to use when calculating portfolio coverage

Floor area is an important KPI set out in question RC5.1 that is then used as a reference point for stating portfolio coverage within the Performance Indicators section. There is currently a lack of clarity regarding the most appropriate floor area and scope to apply when calculating coverage that makes it challenging for participants to accurately complete the Survey.

This issue relates to the complexities in how services can be procured within different property types and what floor areas are best suited when calculating coverages.

The examples provided within the 2018 Real Estate Reference Guide, whilst useful, do not sufficiently cover types of utility and waste management arrangements typically found within the full breadth of property types that commercial property companies and real estate funds invest in. As a result, participants have to decide themselves how coverage should best be calculated, which has caused inconsistency in the approaches used by participants when completing the Survey. Anecdotal evidence suggests that participants are often resorting to the most simplistic option which could over exaggerate portfolio coverage.

Specific issues raised by members include:

- The lack of information on how to convert Net Lettable Area (NLA) to Gross Internal Area (GIA), allowing a potential gaming of the system by under representing the size of common parts area.
- Inconsistency in how maximum potential coverage for shopping centres should be treated. The BBP is aware of scenarios where GIA and common parts area (CPA) are both being considered as values for maximum coverage which result in very different % coverage figures. It would be useful to clarify whether individual retail units within a shopping centre would be considered within the scope of maximum potential coverage, or even whether it should be classified as Indirectly Managed.
- Lack of information on how voids should be treated when calculating coverage.
- Typically, floor area provided for Question RC5.1 will be based on the NLA as this is often the most readily available and accurate data. However, as a result this will not correlate to the total floor area provided for the Performance Indicators as coverage values will require a combination of floor areas, including GIA, NLA and CPA.
- On a more technical point, the upload tool did not allow for the submission of different utilities to service differing floor areas e.g. electricity for common parts and gas for the whole building. This issue required participants to develop workarounds to be able to provide data.

Clarification on these points and a greater number of examples on how coverage should be calculated, particularly for retail properties, would be helpful in guiding participants and increasing standardisation of approaches. Such examples should be split out by property type and potential utility procurement arrangements.

RECOMMENDATION 3

Amend or remove Questions RO5-RO8 relating to whether energy efficiency, water efficiency and waste management measures have been installed across the portfolio

Questions RO5-RO8 ask for information regarding the types of energy efficiency, water efficiency and waste management measures that have been installed across a property company/ fund's portfolio during the last four-year period. There are a number of issues relating to these questions:

- The rationale for the specific timeframe remains unclear as it does not appear to align with warranty periods or average lease lengths.
- Commercial property owners do not generally collect information on the timeframes at which energy and water efficiency measures were installed. At most, they collect whether measures exist or not. This is especially true for companies where churn within their portfolio is high and new properties entering the portfolio are unlikely to have information on installation dates of efficiency measures readily available, or for a new build where there will be no need to install additional measures during the specified timeframe.
- From an ESG performance, it is more important to know whether such measures exist within the property portfolios rather than whether they have been installed over the past four years.
- This is an example of questions that should only be applied to 'Managed Assets'. Firstly, it is very challenging for a property company fund to know what efficiency measures a tenant has installed in an FRI property and therefore to report that information. Typically, the landlord's opportunity to upgrade the property is when a vacant property/space is returned to them. Secondly, if in the instance a tenant invests in efficiency measures at a property with an FRI lease and provides that information for the landlord to report to GRESB, it is questionable whether the landlord should even receive the benefit of additional scoring in the Survey unless they are directly involved in the process e.g. supporting audits or funding.

It is therefore recommended that the questions are simply removed, or that the timeframe is removed and the questions are simplified as to whether such measures exist across a portfolio.

RECOMMENDATION 4

Provide greater clarity on the rationale for collecting intensity data (Question PI1.2, 2.2 and 3.2)

The rationale for collecting multiple year's intensity data is currently unclear when the values do not contribute to scores. In addition, no guidance is provided explaining how intensities should be calculated when aggregating property level data. This is particularly challenging for GHG emissions across regions. The 2018 Real Estate Reference Guide [p133] asks participants to *"calculate intensities using their own calculation method"*, however, in doing so, the lack of comparability makes the exercise somewhat meaningless. It would be useful if GRESB could clarify if there are future plans to include intensity metrics within the scoring process.

In addition, the BBP disagrees with the weighting of scoring applied and feels that too great a weight is applied to normalisation rather than the act of calculating intensities. Maximum scoring requires four levels of normalisation to be applied to intensity data. From the BBP's experience of benchmarking intensities, the greater the level of complexity of normalisation, the more clouded the picture becomes when trying to understand performance, and it distracts from the actual performance of property portfolios. The BBP also has some concerns regarding the normalisation choices:

- It disagrees with the principles of being able to normalise against air conditioning and/or natural ventilation. It sets a dangerous precedent that air-conditioned buildings can be compared evenly in energy intensity terms with naturally ventilated buildings, when clearly air-conditioned buildings should be more energy intensive due to the systems installed.

- The difference between 'Degree Days' and 'Weather Conditions' as separate options is unclear.

- There is a lack of standard industry methodology for normalisation beyond weather, therefore many of the options provided with the Survey are open to interpretation. An absence of normalisation would, in this instance, actually make data sets between different companies and funds more comparable as participants would know they had not been manipulated in any way.

RECOMMENDATION 5

Provide clarity on the methodology for identifying outliers

The 2018 Real Estate Reference Guide states that an in-house developed statistical program is used to identify outliers corresponding to consumption intensity (consumption/area) and/or where change over time is abnormal relative to all reported data for the particular property type. It states that *"All GRESB participants undergo this process and all decisions are automatically protocolled by the system"* and *"abnormal data points that are not the result of incorrect data, but rather the result of unusual business development… [are]… not removed if a reasonable explanation by the respondent exists"* [p23].

A number of members noted instances where the reasoning provided to explain outliers was not accepted, even when data was known to be accurate. It would be helpful if further details were published with regards to the methodology for identifying outliers and how clarifications/disputes should be raised.

For intensity outliers, the Guide states that GRESB checks whether the reported values result in an intensity outside a range of expected values, but it is not clear what these expected values are. For like-for-like outliers, the guidance states that GRESB checks whether the provided values result in absolute percentage changes greater than a threshold between 10% and 20%, however, the actual value is not stated.

From the BBP's own experience of validating performance data, shifts in like-for-like performance of up to 20% can be very common, particularly for GHG emissions where changes in grid intensity are outside the control of property owners.

Future Development

RECOMMENDATION 1

Review opportunities for the Survey to reflect 'performance' of real estate funds and property companies within future iterations

The 2018 Real Estate Survey splits scoring into two dimensions:

- Management & Policy (26.6% of points): the means by which a company or fund deals with or controls its portfolio and its stakeholders and/or a course or principle of action adopted by the company or fund.
- Implementation & Measurement (73.4%): the process of executing a decision or plan or of putting a decision or plan into effect and/or the action of measuring something related to the portfolio.

It is acknowledged that the actual performance of property portfolios, in terms of environmental and social impacts, is measured to a degree within the Survey, with Performance Indicators being the most obvious area. However, scores are much more related to the implementation of corporate policies, data coverage and the ability to provide information as opposed to the actual performance of the properties within the portfolio.

In theory, this scenario is not an issue as GRESB clearly do not state that GRESB scores are a direct reflection of actual performance of an entities property portfolio. However, in practice, this is not the case. Based on discussions with members, investors often assume, albeit incorrectly, GRESB scores directly relate to property performance and that a 5-star GRESB Rating will mean the properties within that company or fund are inherently sustainable and being run in a sustainable way.

The BBP strongly believes that actual performance of a property company and fund's property portfolio should be the most important aspect of any real estate ESG rating and there is a growing recognition and acceptance within the UK real estate market of this principle.

The BBP feels it is only correct that the GRESB Real Estate Survey reflects this shift in time. However, the BBP believes this should be done in a considered and measured way . For example, it may need to be established as an additional dimension or category, rather than simply an addition to the 'Implementation & Measurement' dimension.

RECOMMENDATION 2

Consider the option of fixed-term periods of time where changes are not made to the Survey

The BBP appreciates that it is a challenge for GRESB to annually update the Survey and take on board the feedback from a diverse user base. The BBP would advocate an approach taken by a number of different ratings systems (e.g. BREEAM) whereby the Survey is fixed for a defined period of time (e.g. 3 years), after which changes are implemented before another fixed period. This would provide consistency to participants for the defined period and provide greater time for GRESB to consider the strategic direction of the Survey and consult stakeholders on proposed changes for the next iteration of the Survey.

Debt Survey Recommendations

RECOMMENDATION 1

Continue to operate and develop the Debt Survey in 2019 and beyond

The BBP has played an active role in raising the profile of ESG considerations within real estate lending decisions via its Commercial Real Estate Lending Working Group. It has been a strong advocate of GRESB's Debt Survey since its launch and was even involved in helping shape the initial Survey questions.

The BBP understands that GRESB is planning to close the Debt Survey in 2019 due to poor levels of take-up. The BBP believes this is the wrong decision to take and strongly advocates for its continuation.

The real estate debt market is much larger, in monetary terms, than the equity market and it is felt that it would be short-sighted to ignore such an influential part of the investment sphere when it is only just starting to wake up to the existence of ESG risks and opportunities. The rapid growth of the green bond market and the banking sector's interest in green mortgages for domestic housing provides a clear steer that interest will only increase. The BBP believes that further time should be allowed for it to develop and for interest and participation in the Survey to grow, much in the same way as the Real Estate Survey.

Feedback from the BBP's Commercial Real Estate Lending Working Group highlighted specific questions that it felt were not relevant for lenders and areas for improvement. If GRESB decides to continue the Debt Survey, the BBP would be happy to support its refinement and continue to advocate its use within the UK.

BBP members

- Aberdeen Standard Investments
- Aviva Investors
- Blackstone
- British Land
- bruntwood
- Cadogan
- Canary Wharf Group PLC
- Capital & Regional
- CLS Holdings plc
- Cording Real Estate Group
- The Crown Estate
- DWS
- Great Portland Estates
- Grosvenor
- Hammerson
- Hermes Investment Management
- intu
- Landsec
- LaSalle Investment Management
- Legal & General Investment Management
- lendlease
- Low Carbon Workplace Partnership
- M&G Real Estate
- Norges Bank Real Estate Management
- Schroders
- SEGRO Where Business Works
- Shaftesbury
- nuveen Real Estate
- Transport for London
- Workspace

Editor

Christopher Botten
Programme Manager
Better Buildings Partnership

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Better Buildings Partnership
1 Fore Street, London, EC2Y 9DT

info@betterbuildingspartnership.co.uk
www.betterbuildingspartnership.co.uk

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