



ESG is a process, not a product - by Nicholas Stolatis

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ESG is certainly making an impression on so many of us these days. It's gotten so common that most times there is no explanation offered that the initials stand for environmental, social and governance. It's assumed you know what ESG means. Further, there is a great deal of confusion regarding ESG. Most people, even industry professionals who should know better, are treating ESG as some sort of product. We are seeing it used to label more and more things, like ESG funds.

The ESG label is often applied to funds that promote a special purpose, such as affordable housing, renewable energy, or job creation for special needs individuals. These are all worthy objectives, but they have no explicit claim to being considered ESG. Instead, they are more accurately described as impact investments or social choice investments.

This confusion is creating tremendous stress and tension in the investment space. Investment managers are trying to quantify their level of ESG, while clients and the public are trying to understand where the benefits are coming from. We have some entities opposing ESG as promoting a "socialist agenda", while others are engaging in a form of greenwashing by overstating their actions and activities in an ESG format. This is truly unfortunate as it diminishes the value of ESG, which is sorely needed in our business and personal worlds.

What, exactly, is ESG? It is a process, essentially the implementation of best practices. As such, ESG may be, and should be, found in all sorts of endeavors and businesses. They are especially beneficial and appropriate in the real estate investment world.

Let's consider some ways as to how ESG would be applied to real estate investments.

It is acknowledged that our real estate is a major contributor to greenhouse gas emissions. There are many different opinions as to the specific percentages attributable to buildings. The numbers frequently quoted appear to be on the high side, considering the numbers separately attributed to other categories such as transportation, agriculture and naturally occurring carbon emissions. If we calculated the sum of all of these allotments, total emission would far exceed 100%. Regardless of the true percentage, it's clearly desirable for our building stock to be as "clean" as possible.

On the social side, buildings should not be dangerous for their occupants. Health and wellness is a fundamental objective for all buildings. This is provided when there is adequate ventilation, and thermal comfort. Ample natural lighting is also considered necessary, along with other features. "Social" also includes responsible labor practices, such as fair, or competitive, wages, safety protocols, respect for employees and implementing diversity and inclusiveness when hiring and promoting.

On the governance side, we find concepts such as controls and reporting. Having relevant and pragmatic policies and procedures is essential for any organization to have a consistent level of quality and performance. Compliance, in the form of training and auditing, ensures that the policies and procedures are implemented properly. Reporting represents the aspect of transparency, which

communicates critical information to stakeholders and other interested parties.

Embedded within the broad spectrum of ESG activities is the principle of ethics and ethical behaviors. Honesty, respect, fiduciary duty and compliance with rules and regulations are essential if we expect our relationships and interactions with others to be meaningful and productive over the long run.

Most industry professionals speak of the need for our real estate to achieve the triple bottom line, commonly presented as people, planet and profit. All three elements are equally important. After all, investments explicitly require a reasonable return in order to attract investors. While charities are supposed to operate without a profit motive, even they need a steady inflow of funds to support their ministries. Embracing ESG principles and practices enables an investor, or manager, to generate the best sustainable returns on the investment.

I'm looking forward to the day that we can differentiate between ESG as a fundamental business practice, and impact investing as a socially driven investment product. Until that happens, I fear we will continue to see confusion and disagreement with respect to ESG, and its importance to real estate investments. Therefore, it is incumbent on us, as real estate professionals, to inform and educate our respective audiences on the true meaning and value of ESG by embracing and implementing ESG best practices in our own operations. Let's all commit to making it happen.

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