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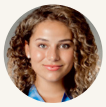

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ESG and Impact Investing in Private Market Real Estate

A guide to sustainable investing risk exposure, management, and opportunities in real estate

PitchBook is a Morningstar company providing the most comprehensive, most accurate, and hard-to-find data for professionals doing business in the private markets.

Introduction

Real estate is involved in everything we touch. Food is grown or raised on agricultural land; clothing and technology are manufactured and distributed via industrial properties; and the places we spend most of our lives, our offices and homes, are commercial and residential real estate. Yet, unfortunately, sheer proximity to this asset class does not translate to understanding of its complexities, including those pertaining to sustainable investing in it. For many private market participants, questions have arisen in recent years around how environmental, social, and governance (ESG) frameworks and Impact investing fit into real estate. With respect to LPs with ESG commitments considering investing in the asset class for its inflation-hedging abilities, these questions might center on how ESG commitments flow through to portfolios of properties rather than of companies and how this affects what questions should be asked of asset managers during diligence. For real estate-focused GPs, questions may relate more to what ESG means in the asset class beyond the familiar environmental basics.

Industry participants have struggled to navigate the opaque sustainable investing landscape, characterized by its surfeit of standards, frameworks, metrics, and buzzwords. The lines between ESG and Impact can be blurry, and the legitimacy of how they are practiced in the investment world can be even blurrier. Compounding these issues is the fact that each asset class, industry, and individual investment require awareness of a different set of ESG risk exposure points and opportunities, as well as have varying capacity to create positive social and environmental impact. While what an investor considers legitimate ESG and Impact may be somewhat subjective, cognizance of potential risks and opportunities is beneficial across the spectrum. This note aims to comprehensively surface the ESG-related risks and sustainable investing opportunities presented in private market real estate investing, across strategies and property sectors. Ensuring material risks are mitigated where appropriate and opportunities capitalized on where fruitful will prevent unnecessary losses and improve the upside potential of real estate assets. While they are discussed at the asset level, the material financial impacts of these ESG factors roll up to the fund level, and, as such, are relevant to GPs, LPs, and consultants alike.

Terminology

ESG risk exposure: This term refers to the extent to which an asset is vulnerable to a particular ESG risk or set of risks, not taking into account the degree to which the risk is being managed. At the asset level, exposure is determined largely by the asset type, its industry, location, operations, and other idiosyncratic factors. However, exposure can also be generalized at an industry or location level.

Risk management or mitigation: In the context of ESG, risk management, or risk mitigation, refers to the practice of addressing risk exposure through programs, policies, procedures, practices, or other methods in order to reduce the likelihood of the risk actualizing or the magnitude of the negative impact of the risk should it actualize. Risk management is concerned with reducing potential downside.

ESG opportunity: This term refers to an opportunity for an asset to benefit—where it would not otherwise have—from the adoption of some program, policy, procedure, or practice falling under the umbrella of ESG. Of note, while an ESG opportunity may benefit society—for example, the building of green buildings reducing environmental harm—this term is focused on the upside benefit of the opportunity to the asset—for example, the asset fetching a "green premium," paying less for utilities, and/or experiencing increased tenant satisfaction. In addition, ESG opportunities may arise from the same activities that mitigate risk; for example, installing solar panels will help mitigate climate change transition risks as well as capitalize on an opportunity to reduce utilities costs.

Impact opportunity: An Impact opportunity is one in which an asset has the potential to benefit society, either environmentally or socially, through its operations. Unlike ESG opportunities, Impact opportunities are focused on the potential magnitude of an activity's positive effects on society rather than how the opportunity will benefit the asset's performance. For example, a multifamily real estate asset may have a social Impact opportunity to offer affordable housing, but this may not result in any additional financial benefit to the asset. This is not to say that Impact opportunities cannot also result in increased returns, as some opportunities do, but that this is not the primary aim of the opportunity.

Real estate strategy: In the context of this discussion, this term refers to the high-level investment strategies commonly discussed in private market real estate: core, core plus, value-add, opportunistic, distressed, and debt. For a robust description of what these strategies typically entail, check out our Private Markets Real Estate Fundamentals piece.

Real estate sector and subsector: The four real estate property sectors are residential, commercial, industrial and land. Within these sectors are subsectors, such as multifamily residential, office space within commercial, logistics within industrial, and agricultural land. For a detailed explanation of the dynamics at play in these sectors and subsectors, check out our Private Markets Real Estate Fundamentals piece.

ESG in real estate

At a high level, ESG is concerned with awareness and consideration of risk factors and value creation opportunities that fall into the categories of environmental, social, or governance-related topics. ESG-aligned investing utilizes this risk and opportunity analysis alongside traditional investment considerations to improve returns by protecting against downside and capitalizing on ESG-related potential.[1] In the context of real estate, discussion of ESG tends to focus on the environmental component. As land and edifices possess a great degree of permanence, proactive preparedness around upcoming regulation, resource constraints, and climate-related challenges is paramount. However, real estate investments do also experience exposure to issues in the social and governance categories. Although operations may be more limited, idiosyncratic risks around interactions with tenants and regulators are present for this asset class.

In addition, it is worth noting that ESG risk and opportunity are not constant for a particular property, but rather will fluctuate depending on the property's stage of development. For example, supply chain management risk exposure tends to be higher during property development, more commonly done within value-add and opportunistic strategies, as construction, remodeling, and renovation are major exposure points due to increased sourcing of services and materials. Similarly, opportunity is more substantial where change is possible and probable. For example, an investor is more likely to be able to capitalize on opportunities around building energy-efficient buildings during property development and remodeling. So, if using a core investment strategy, some aspects of this opportunity, such as orienting a building toward or away from natural lighting, would not be feasible. The following list of potential ESG risk and opportunity areas material to real estate investments will be relevant to some strategies, sectors, and subsectors and not to others.

ESG risk and opportunity areas include:[2]

- Climate change adaptation (Environmental)
- Energy and water management (Environmental)
- Environmental compliance and ecological impacts (Environmental)
- Management of tenant sustainability impacts (Environmental and Social)
- Employee engagement, diversity, and inclusion (Social)
- Employee health and safety (Social)
- Healthy buildings and communities (Social and Governance)
- Supply chain management (Governance)
- Business ethics and regulatory compliance (Governance)

Climate change adaptation: Climate change presents physical risks—such as rising sea levels and extreme weather events including wildfires, flooding, and severe storms—and transition risks—such as mandated integration of green energy, greenhouse gas reduction requirements, and technological shifts to accommodate low-carbon solutions—to real estate investments. Physical risks tend to be more

1: For more on the history of ESG, check out our analyst note ESG and the Private Markets.
2: ESG risk and opportunity areas are derived largely from the Sustainability Accounting Standards Board's (SASB)/International Sustainability Standards Board (ISSB) framework. Areas have been added, modified, or adjusted where appropriate for applicability to private market real estate investment.

actual and intuitive, while transition risks, encompassing policy, legal, technology, market, and reputational risks associated with an economic transition to a lower-carbon economy, involve more speculation.[3] Awareness and mitigation of these risks are relevant to most property types, but particularly for those in coastal regions or floodplains and those in areas vulnerable to severe environmental impacts such as wildfire hazard zones. In addition, property types for which physical risks are more likely to substantially harm asset values, such as agricultural land, are highly exposed. Transition risk exposure is highest for property types using large amounts of energy and equipment for operations, such as manufacturing or data centers.

The impacts of this risk on investments may include costs associated with property damages, heightened insurance rates and, in extreme situations such as California and its wildfires, inability to gain access to insurance. Further, impacts associated with regulatory noncompliance or costs linked to retrofitting to meet regulatory requirements should also be considered. While climate risks are omnipresent, an ESG framework can help investors mitigate risks rather than simply accept them. For physical risks, potential owners might begin by utilizing analysis of risk exposure points such as location and building structure. If considered during the due diligence stage, investors may choose to reprice or forgo investments in properties based on high exposure to physical risks. For material physical risks, policies and procedures such as business continuity plans and emergency response plans can be developed and implemented for mitigation purposes.[4] For transition risks, investors might consider engaging with policymakers to determine where regulation is going and get ahead of potential requirements, integrating green energy or low-carbon technologies into development plans.

Energy and water management: Energy and water management, referring to how those resources are utilized, consumed, and tracked, present both an ESG risk and opportunity in real estate investments. Poor energy and water management can be needlessly costly, thus manifesting in higher utility bills. If environmental harm is created, assets may be affected by costs associated with government efforts to internalize these negative externalities. Depending on the area, resource scarcity may also result from poor energy and water management, thereby putting even more upward pressure on costs when shortages occur. Programs that focus on energy and water efficiency, while potentially requiring up-front capital to make improvements, both mitigate risks and capitalize on opportunity, often resulting in lower overall utility costs in the long term. While large transitions such as adoption of solar energy may be more impactful to the bottom line, even small conversions can be beneficial, including use of LED lighting, Energy Star-rated appliances, and window treatments. Energy management considerations are relevant to most industrial, commercial, and residential property types. Water efficiency is applicable to the same groups, with the addition of land property types. Geographically, risk exposure points for energy management include areas with extreme or fluctuating temperatures and for water management include areas experiencing water stress.

3: "Recommendations of the Task Force on Climate-Related Financial Disclosures," Task Force on Climate-Related Financial Disclosures, Michael R. Bloomberg, et al., June 2017.

4: James Bilko, Senior ESG Consultant at Ramboll, telephone interview by Anikka Villegas, March 9, 2022.

The first step for investors in assessing energy and water management risks is gathering information on consumption compared with previous periods and industry standards. In real estate, mitigation of energy and water management risks often involves the use of energy- and water-efficient appliances such as low-flush toilets or automatic sinks; regular maintenance of equipment, plumbing, or appliances to keep apprised of leaks or other needed repairs; and practices such as water reclamation.[5] In addition, some aspects of energy management, such as orientation toward sunlight and areas of shade or use of appropriate insulation, can be implemented only during development, as retrofitting for these purposes may be either impossible or prohibitively expensive.[6] Lastly, energy management may involve a transition to renewable energy such as solar, wind, or hydropower, rather than natural gas, or supplementing traditional energy sources with renewables.

Environmental compliance and ecological impacts: Environmental compliance speaks to the burdens related to adhering to environmental regulations and risks of failing to do so, while ecological impacts are focused on the effects of a property on local ecology within permitted activities. While both are relevant to all property types, the former is especially material for commercial and industrial property types because activities occurring on the property more frequently involve the production of hazardous wastes, substantive emissions, or other outputs that create heavier compliance obligations. Ecological impact concerns are most relevant to land and industrial property types, which are more likely to be, or are definitionally, in less metropolitan areas, where there is more wildlife and plant life to be affected. New developments in areas with sensitive ecosystems are one of the most exposed property types.

The impacts of this risk being poorly managed may include litigation costs, developmental disruptions or shutdowns in property development or renovation, reputational damages, and regulatory fines and penalties due to noncompliance. To mitigate risks around environmental compliance and ecological impacts, GPs may request to see previous environmental site assessments, including Phase Is and Phase IIs, soil sampling, and environmental impact assessments—and/or commission new ones themselves. During the holding period, asset managers can address risks through use of root cause analysis on any environmental incidents occurring on the property and by ensuring procedures are in place around proper storage of chemicals, waste, and other hazardous materials.[7] While the ultimate responsibility for maintaining environmental compliance and preventing ecological harm may fall to the tenants in many situations, property owners might wish to proactively work with tenants to prevent incidents that may be costly and/or ultimately reduce the value of the property.

Management of tenant sustainability impacts: To the extent that tenants have control over the property's consumption of resources, environmental impacts, and health or social impacts on residents or local civilians, real estate investors are exposed to risks related to the management of these impacts. Aside from any potential liability associated with tenant activities, investors are exposed to reputational risks associated with tenant conduct. Management of these risks may

5: James Bilko, Senior ESG Consultant at Ramboll, telephone interview by Anikka Villegas, March 9, 2022.
6: Brittany Bossel, ESG Analyst at Bridge House Advisors, telephone interview by Anikka Villegas, June 16, 2022.
7: Ibid.

involve utilizing contractual obligations or incentives, such as cost recovery clauses for resource efficiency-related improvements, to prevent negative outcomes and encourage positive ones. This issue is material for residential, commercial, and industrial property types in most locales. Additional exposure points include developments in locations traditionally inhabited by vulnerable populations such as low-income individuals and majority ethnic minority communities. Backlash around gentrification and negative physical health impacts for vulnerable communities have become increasingly common in recent years but can be mitigated by proactively consulting with community leaders.

Management of this risk first mandates awareness of tenant sustainability impacts. Knowledge of the social and environmental effects of a tenant's operations may require use of more formal environmental assessments, touchpoints with locals, or transparent communication with lessees. While property owners may not always have control over tenant operations, at a minimum, owners may educate and support tenants in reducing negative impacts and creating positive ones. To create buy-in with the community on development projects, investors may draw from the local talent population, stimulating the economy and thus garnering more support.[8] In addition, on the investor side, mitigation of risks in this area may actually start with exclusion of property types with specific end uses. For example, investors may choose not to purchase properties to be used for private prisons due to social sustainability concerns around their ethics.

Employee engagement, diversity, and inclusion: While properties may not require the massive workforces that other capital recipients in private equity (PE) and venture capital (VC) do, there are sometimes still employees involved in property management, development, and upkeep. Ensuring that employees are recruited and treated in an equitable and inclusive manner and avoiding excessive turnover or employee dissatisfaction through employee engagement initiatives can help reduce labor costs, litigation costs, and regulatory and public scrutiny. While specific property types may not be particularly exposed, those with a larger workforce experience more risk in this area, so scale is certainly a factor. Hospitality and recreation, as well as agricultural land property types, tend to employ more workers and thus experience more exposure.

To mitigate risks in this area, investors may choose to develop and train on policies including employee handbooks, diversity and equal employment opportunity policies, and anti-discrimination and anti-harassment policies, among others. In addition, ensuring that diversity data is being tracked and reported to appropriate regulatory bodies, such as the Equal Employment Opportunity Commission in the US, employee voluntary and total turnover is being recorded, and employee complaint and litigation numbers are evaluated may be necessary to address risks.

Employee health and safety: Similar to the above topic, employee health and safety is a potential risk to the extent that the property's development or maintenance involves the recruitment and retention of a workforce. The size of the workforce and the activities that it engages in will determine risk exposure in this area. Higher-risk activities include construction, physical labor such as may be involved in land maintenance, and those necessitating the use of chemicals such as sanitization and

8: James Bilko, Senior ESG Consultant at Ramboll, telephone interview by Anikka Villegas, March 9, 2022.

cleaning. The majority of the time, property development involves contracting with a construction company rather than employment of the workforce by the property or asset manager. In this case, worker health and safety would be considered a supply chain risk.

If risks are left unmanaged in this area, costs may result related to employee litigation, regulatory action and associated fines, penalties, and operational shutdowns; higher workers' compensation insurance costs; and negative impacts on employee and public sentiment around the asset's brand. If not existent, investors may facilitate the development of an employee health and safety program, including a written policy suite describing appropriate procedures for higher-risk activities such as handling concentrated cleaning chemicals, training records, and auditing procedures. Appropriate reporting to regulatory bodies, such as to the Occupational Safety and Health Administration in the US, may also be important to address risks in this area.

Healthy buildings and communities: Healthy buildings refer to those that offer an indoor environment that positively affects the physical and mental health and well-being of those spending time in them. This issue presents both an ESG risk and opportunity. On the risk side, many aspects of healthy buildings fall under the umbrella of legal or regulatory compliance issues, such as compliance with air quality requirements and building security. Typically, if buildings do not possess the qualities that would make them "healthy," the impacts of the risks pertain mostly to potential litigation, regulatory penalties and fines, and poor tenant retention. The term "healthy communities" expresses an extension of the idea of healthy buildings to those developments that constitute more than an edifice or a few edifices. Healthy communities are typically more walkable, foster a sense of togetherness through shared spaces and resources, and have regard for spatial efficiency and the impact of the built environment on community members.[9]

On the opportunity side, healthy buildings may mean increased tenant satisfaction resulting in improved occupancy rates and property values. Walkable neighborhoods that facilitate community cohesiveness are also increasingly in demand, especially among younger generations.[10] Investors may keep an eye out for, or actively integrate, healthy building features including proper ventilation, comfortable humidity levels, natural lighting, enjoyable views, and noise maintenance, among others.[11] In addition, spaces that facilitate socialization and productivity may fall into this category. In order to manage risks and/or capitalize on opportunities, investors will need to be aware of any gaps that should be addressed. Utilization of assessments with respect to healthy building features may be appropriate alongside remediation of any deficiencies, first focusing on legal and compliance-related issues and then addressing opportunities.

Supply chain management: Property development and maintenance may require the sourcing of products or services that expose the property's manager or developer to social and environmental supply chain risks. For example, as mentioned above, contracting with an external team for construction creates

9: Brittany Bossel, ESG Analyst at Bridge House Advisors, telephone interview by Anikka Villegas, June 16, 2022.
10: "Aligning Real Estate with a New Generation of Environmentally Conscious Buyers," EisnerAmper, Danielle Barrs, March 7, 2022.
11: "A Healthier Future Starts Indoors," Carrier, n.d., accessed on July 1, 2022.

exposure to social supply chain risks around ensuring the construction team maintains adequate policies and procedures to prevent employee injury and illness in their workforce. As some building materials can be sourced in ways that are destructive to the environment, such as timber that contributes to deforestation and wildlife habitat destruction from logging, it is important for real estate investors to be aware of the supply chain implications of such purchases.[12] This risk is also fairly property-type-agnostic and is more tied to which strategy is being used to create value; for example, new property developments and significant construction or renovation create greater exposure.

The impacts of supply chain risks in real estate are largely reputational but also include potential negative operational impacts, as incidents in the supply chain such as severe employee injuries or noncompliance resulting in regulatory intervention may result in a supplier being unable to deliver their goods or services on schedule. Management of social and environmental supply chain risks frequently involves tracing inputs; identifying and engaging with product sources; utilizing assessments and audits to document and evaluate input lifecycles; and maintaining a supplier code of conduct that details supplier standards. In addition, contracts with suppliers or contractors might include stipulations around compliance with a supplier code of conduct or explicitly mandate alignment with particular regulations or standards. Lastly, efforts to recycle, reduce waste in property development, and extend the useful life of existing materials may be looked upon favorably by potential tenants or future buyers.[13]

Business ethics and regulatory compliance: While exposure in this area is generally low, a few factors elevate it. The development of properties, especially those converting use or creating new use may involve government touchpoints for employees. Interactions with government employees create exposure to ethical risks around perceived or actual impropriety. In addition, geographical exposure may create bribery and corruption risks, as developments in countries where facilitation payments, bribes, or kickbacks are more common may result in situations wherein personnel must navigate potentially dangerous interactions with public officials or community members. Selection of and interactions with tenants creates ethical obligations around ensuring nondiscriminatory and respectful conduct. On the compliance side, there are a variety of regulatory burdens created by the development and day-to-day operation of properties. For example, property owners should be aware of and proactive regarding accessibility-related compliance issues pertaining to the property itself, such as availability of ramps, accessible parking spaces, and Braille signage.[14]

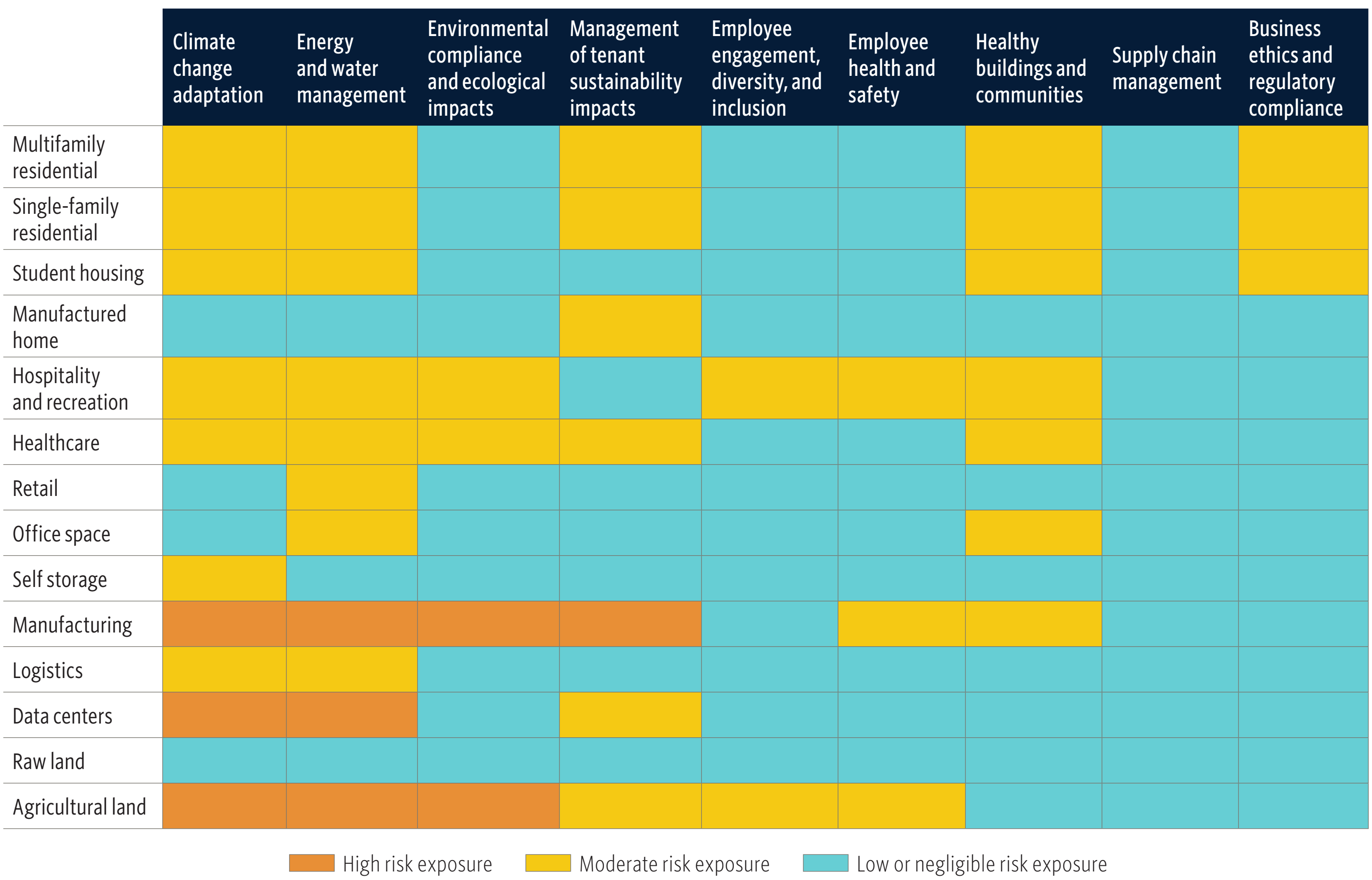
Unmitigated risk in this area may result in noncompliance with the aforementioned types of regulations, as well as those related to anti-bribery, such as the US Foreign Corrupt Practices Act (FCPA) or the UK Bribery Act (UKBA). Impacts on the property owner may include public scrutiny, fines and/or imprisonment of employees, reputational backlash, and litigation, as well as potential operational shutdowns. Investors may look to mitigate the ethical risks related to employee conduct by developing and training on policies such as employee codes of ethics

12: Brittany Bossel, ESG Analyst at Bridge House Advisors, telephone interview by Anikka Villegas, June 16, 2022.
13: James Bilko, Senior ESG Consultant at Ramboll, telephone interview by Anikka Villegas, March 9, 2022.
14: Brittany Bossel, ESG Analyst at Bridge House Advisors, telephone interview by Anikka Villegas, June 16, 2022.

and anti-bribery and corruption policies. Use of tools such as background checks of employees may be especially important if operations involve many touchpoints with tenants—even more so if tenants are members of vulnerable groups. Other procedures such as implementation of rental discrimination or fair housing audits may be used by investors to ensure tenant selection is nondiscriminatory. Ultimately, the degree of exposure to this risk depends heavily on the location of the property and the strategy in use. Utilization of legal counsel may be necessary to understand which risks are most salient.

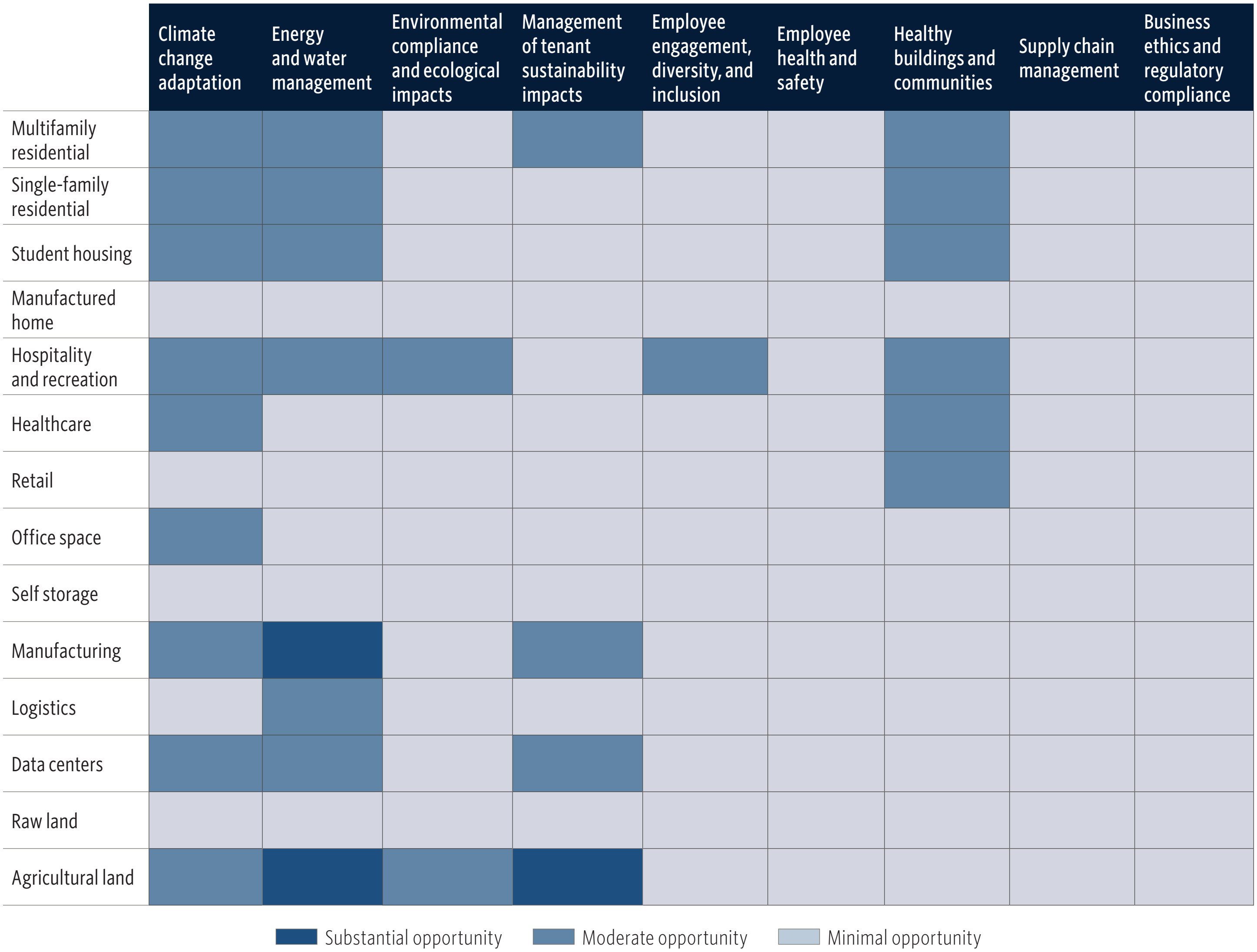
ESG in real estate across property subsectors and strategies: The below visualizations offer a high-level qualitative representation of typical ESG risk exposure and opportunity across property subsectors and strategies. While the characterization of risk or opportunity as low or high will not apply to every property in every location, the visuals can guide investors to the areas on which resources should be focused when performing due diligence and managing real estate investments. Figures 1 and 2 speak to exposure and opportunity for the typical already-established property across various sectors. Figures 3 and 4 indicate exposure and opportunity based on the kinds of activities and quality of property typically involved in each real estate strategy.

Figure 1: Typical ESG risk exposure for property subsectors



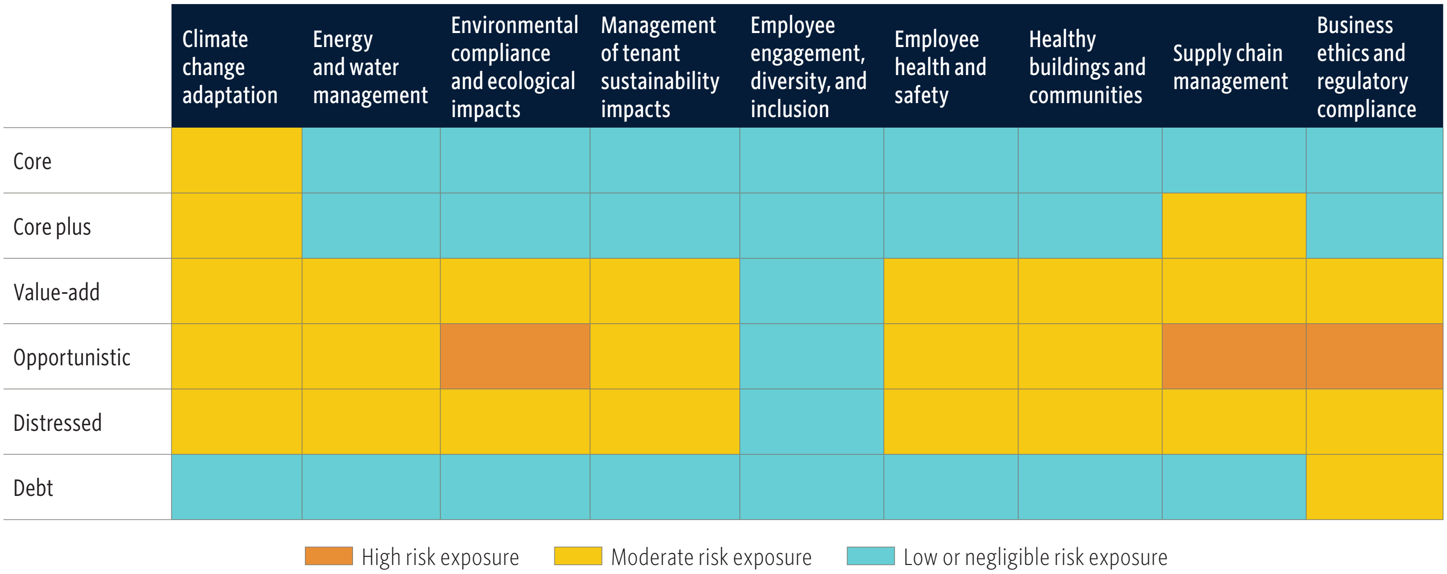
Source: PitchBook | Geography: Global

Figure 2: Typical ESG opportunity level for property subsectors



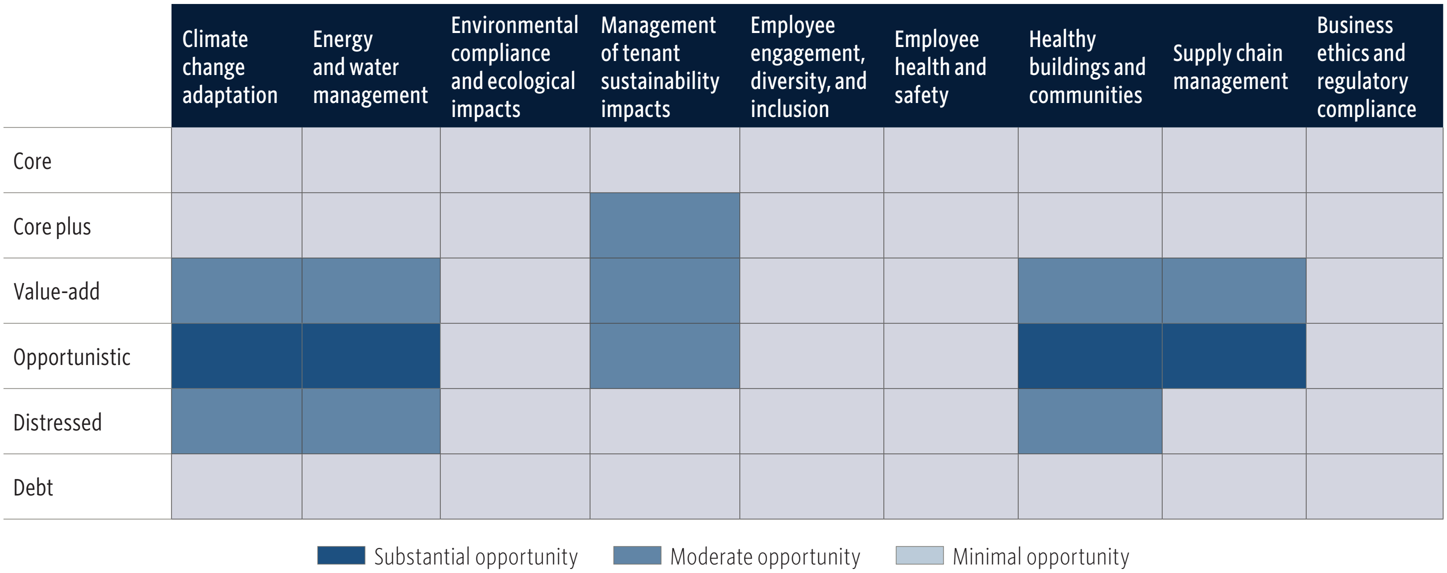
Source: PitchBook | Geography: Global

Figure 3: Typical ESG risk exposure for real estate strategies



Source: PitchBook | Geography: Global

Figure 4: Typical ESG opportunity level for real estate strategies



Source: PitchBook | Geography: Global

Impact investing in real estate

In the context of investing, Impact refers to the positive environmental and social effects an asset has on the external world. Impact investing seeks to achieve the dual goals of creating both financial returns and positive social and/or environmental impact.[15] Real estate Impact investments typically fall into a few categories and meet certain thresholds of impact to qualify, which are dictated by the perspective of the investors and their stakeholders. The categories, listed below, encompass the Impact themes most likely to be relevant to real estate investments. As with ESG, there are some Impact opportunities that are presented in real estate only under certain circumstances, typically found among value-add and opportunistic strategies. For example, it would be difficult to create Impact under the Economic Development and Opportunity Zones category when using a core strategy, as core properties are definitionally located in already-developed areas with strong occupancy.

Impact opportunity areas include:

- Economic development and opportunity zones (Social)
- Affordable housing and Impact tenants (Social)
- Green buildings (Environmental)
- Sustainable land management and sustainable forestry (Environmental)

Economic development and opportunity zones: Investment in properties located in areas that will benefit substantially from the economic stimulus derived from the investment is one means of creating social Impact through real estate. Investment may lead to an increase in available jobs due to property development or activities occurring on the property, attraction of a demographic that will financially benefit the community, such as tourists, or aiding in access to necessary goods or services, such as with healthcare and some retail properties.

Opportunity Zones are a US tool designed to encourage real estate investment in order to improve economically distressed areas through tax incentives. Developments in Opportunity Zones are meant to stimulate economies of areas in decline by creating jobs in low-income communities via property development-related work, offering more or better housing, or introducing new business. While this program has had some success, it is set to sunset at the end of 2026. Although a bipartisan group of lawmakers introduced a bill to extend and improve upon it in April 2022, it remains to be seen whether the bill will be passed, and, if so, whether it will have a substantive impact on the space.[16]

Targeting properties in opportunity zones or investment in properties to stimulate local economic development as an avenue for creating Impact would be well aligned with opportunistic and distressed strategies. Investors will need to thoughtfully approach this manner of creating Impact, as concerns around the harms of

15: For more on the history of Impact investing, check out our analyst note, The Double Bottom Line: Private Market Impact Investment.
16: "Renewed Opportunities: Recent Bipartisan Proposal Seeks to Refine Opportunity Zone Development and Tax Incentives," JD Supra, Alyson Hoffman and Amanda Wilson, April 18, 2022.

gentrification have grown in recent years and economic development frequently displaces lower-income individuals.

Affordable housing and Impact tenants: With affordable housing, residents with an income at or below a government- or approved agency-dictated median can pay rent while still having residual income for other necessities. Potential residences may include nonstandard property types such as transitional housing, subsidized or rent-controlled housing, or affordable homes. Use of affordable housing as a means of creating Impact would be well aligned with value-add, opportunistic, or distressed strategies.

Affordable housing may involve leasing to Impact tenants or members of vulnerable groups, including those who have historically been susceptible to oppression, harm, or inequalities. However, some properties, such as student housing, may not qualify as affordable housing but still house members of vulnerable groups. Under some circumstances, these assets will still qualify as Impact investments.[17]

In addition, with regard to real estate debt portfolios, another potential avenue for creating Impact may include purchasing and creating a workout, or solution to a defaulted loan to avoid a bankruptcy proceeding, for the nonperforming mortgages of low-income or disadvantaged borrowers.[18] Naturally, this would qualify only under the conditions that the borrowers remain in possession of their assets, as the positive social Impact associated with this activity would no longer exist if they were foreclosed upon.

Green buildings: Green buildings encompass a wide variety of edifices, including buildings that, through design, construction, or operation, reduce or eliminate negative impacts and/or create positive impacts on the environment. This may be through resource efficiency or use of renewables, waste reduction measures such as recycling or re-use, or use of nontoxic or environmentally friendly materials. Because any building can be made into a “green building,” investors may need to verify that the sustainability of a building aligns with their level of desired Impact.

Due to demand for and cost of retrofitting, green buildings tend to be located in more populous and affluent metropolitan areas, and, as such, are associated with higher property values. Green building creation and management can be utilized as an Impact strategy alongside core plus, value-add, opportunistic, and distressed strategies. Unlike many other Impact opportunities, green buildings are frequently able to positively influence returns by fetching “green premiums” when brought to market.

Sustainable land management and sustainable forestry: Sustainable land management refers to the use of practices and technologies that minimize land degradation, rehabilitate degraded areas, and/or ensure efficient or optimized use of land resources such as soil and water. Sustainable forestry aims to balance the economic needs of society with the ecological needs of the environment. This is often done by mimicking natural patterns of environmental disturbance and regeneration, which helps to conserve and replenish natural resources. This avenue

17: Muhammad Koya, Senior Associate Product Manager of ESG Products at Sustainalytics, telephone interview by Anikka Villegas, June 16, 2022.
18: Ibid.

of creating Impact is most relevant to private market investors in agricultural land, although it may be applicable to raw land, or untouched terrain, and some hospitality and recreation properties such as ski resorts or country clubs.

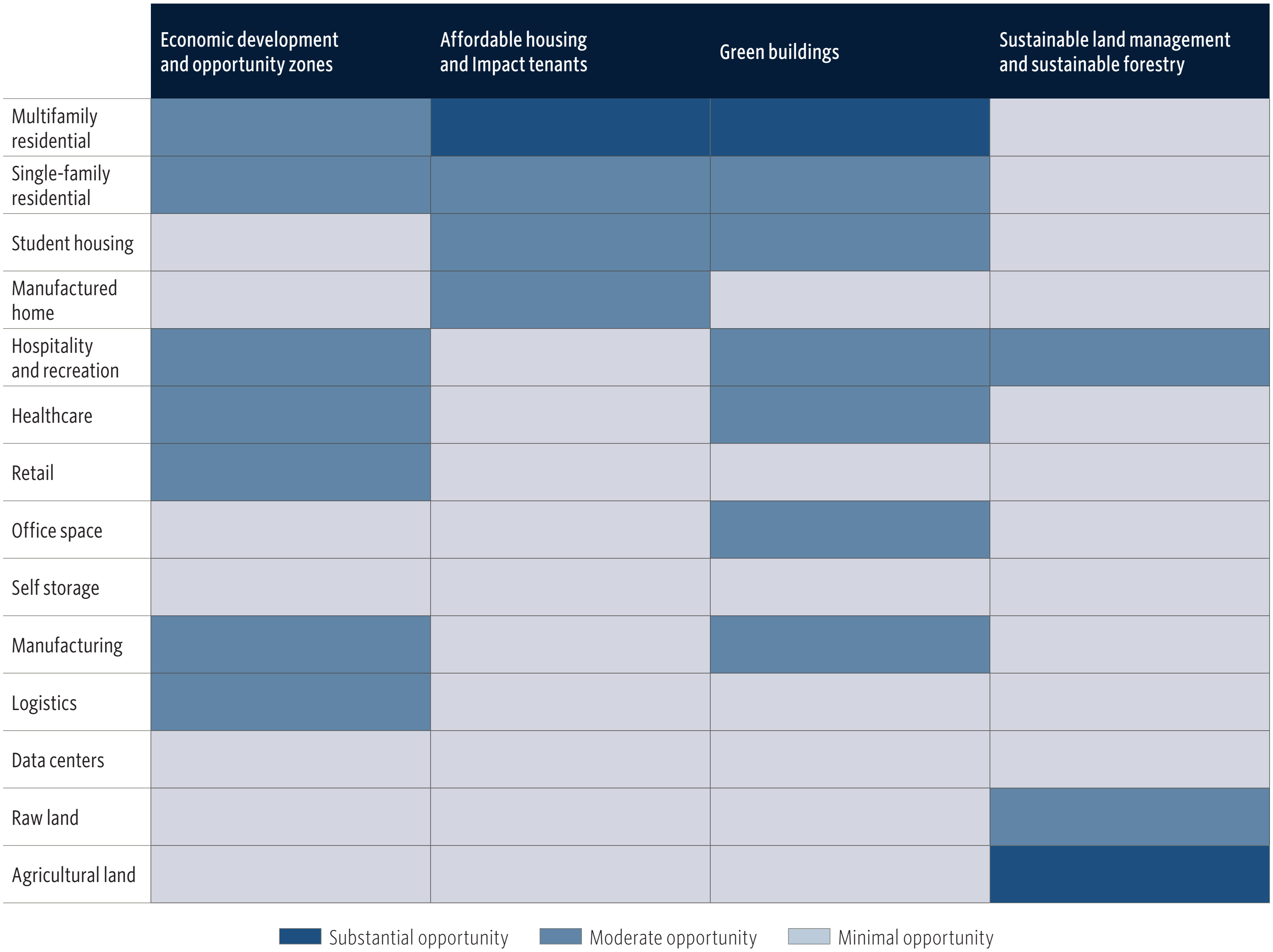
With respect to agricultural land, a substantial opportunity exists to benefit financially from this Impact avenue, as discussed in our Q1 2022 Agtech Report. Land that has been certified organic or utilizes regenerative agricultural methods—a set of sustainable farming practices that aims to restore farmland and conserve natural resources—can be priced higher. This is because the land's value is predominantly dictated by what can be grown on it, when, and with what degree of success.[19] As such, avoidance of chemical dependency, topsoil loss, decreased biodiversity, and other features of unsustainable agriculture land management will create positive environmental impact and potentially bolster returns.[20] Typically, for hospitality and recreation properties as well as raw land without planned development, this type of Impact involves more avoidance of harm and preservation of local ecology and resources than concerted improvements like those used with agricultural land.

Strategy-wise, this Impact channel is well aligned with value-add and opportunistic approaches with respect to agricultural land and hospitality and recreation assets, as considerations around these topics are more relevant when approaching intensive development or substantial changes to a property. For raw land, strategy alignment is more complex, as a buy-and-hold and do-no-harm approach relies on appreciation of the property but does not allow for substantial development of it. As such, its potential longevity as an Impact strategy may be somewhat limited, as investors in raw land often sell to investors planning to develop.

Impact in real estate across property subsectors and strategies: The below visualizations offer a high-level qualitative representation of potential Impact opportunity across property subsectors and strategies. While the characterization of opportunity as minimal or substantial will not apply to every property in every location, the visuals can serve as guidance for which strategies and sectors are most likely to have suitable Impact opportunities for investors. Figure 5 speaks to Impact opportunity investing across various subsectors, and Figure 6 indicates Impact opportunity based on the kinds of activities and quality of property typically involved in each real estate strategy.

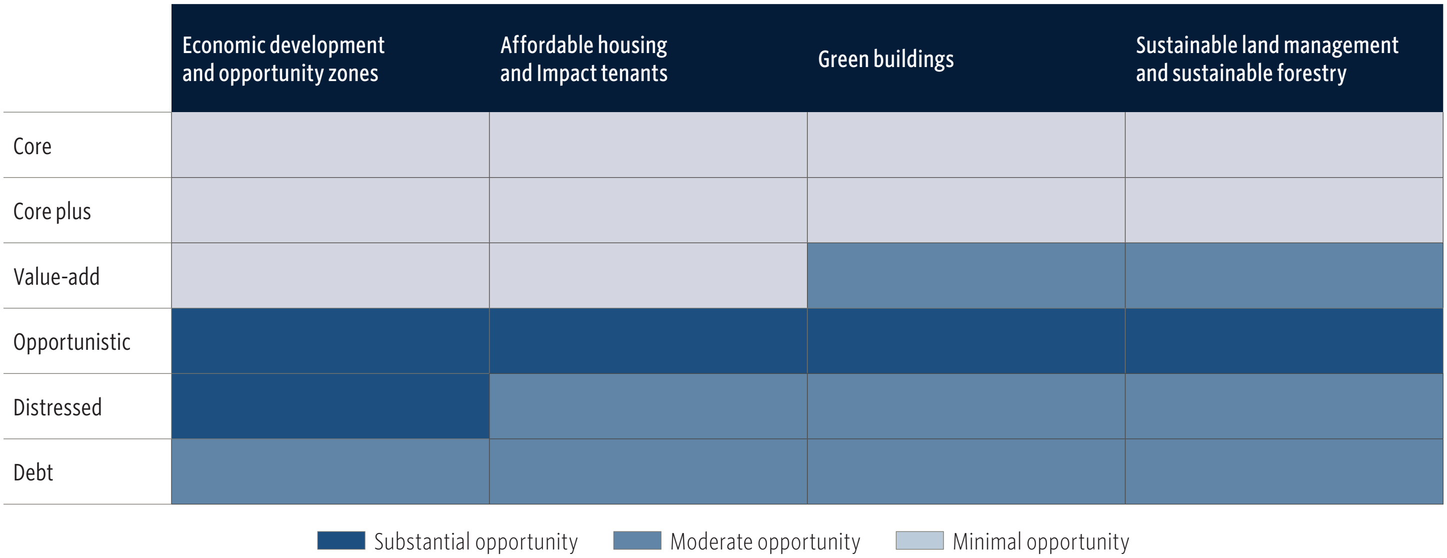
19: Craig Wichner, Managing Partner of Farmland LP, phone interview by Anikka Villegas, March 25, 2022.
20: Ibid.

Figure 5: Typical Impact opportunity level for property subsectors



Source: PitchBook | Geography: Global

Figure 6: Typical Impact opportunity level for real estate strategies



Source: PitchBook | Geography: Global