Real estate’s environmental impact is significant. In the European Union, buildings are responsible for 40% of overall energy consumption and 36% of greenhouse gas (GHG) emissions, much of which is generated from the construction and operation of properties.\(^1\)

At the same time, three out of four EU buildings are considered energy inefficient.\(^1\)

Core real estate investors have demonstrated a desire to change these dynamics and continue to make environmental, social, and governance (ESG) factors a top priority. Achieving carbon neutrality has been a particularly high priority, as organisations are increasingly committing to reducing their carbon footprint. This goal has already altered the landscape and will only become a higher priority for more businesses, governments, and investors. The number of real estate companies and investment funds focused on carbon neutrality continues to increase at a rapid pace, accelerated by the European Commission’s adoption of regulations last year aimed at achieving net zero carbon by 2050.\(^2\)

But not all approaches to carbon neutrality are equal. Business leaders are often quick to agree to long-term carbon reduction goals without a full understanding of implementation at the individual property level.

To understand exactly how a company or fund plans to meet their stated carbon reduction goals, investors should be prepared to ask several important questions when evaluating initiatives and measuring results.

**Definitions matter**

One of the biggest obstacles to understanding a carbon reduction programme’s impact is a lack of a uniform definition and consistent approach to carbon neutrality. The path by which funds achieve carbon neutrality can vary greatly depending on what activities are pursued, such as emissions reduction via operational improvements versus purchasing environmental attribute certificates (EACs) and carbon offsets.

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\(^1\) https://ec.europa.eu/info/news/focus-energy-efficiency-buildings-2020-feb-17_en

\(^2\) https://eur-lex.europa.eu/resource.html?uri=cellar:d84ec73c-c773-11eb-a925-01aa75ed71a1.0021.02/DOC_1&format=PDF

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For example, a real estate portfolio that excludes tenant energy consumption from its footprint could easily overlook the vast majority of emissions occurring within its properties. In addition, a business could theoretically measure its emissions and then buy carbon offsets the next day and claim to be carbon neutral without verifying the quality of the offsets or making any attempts to reduce operational emissions.

While technically the business would be carbon neutral—because they are balancing emissions with offsets—this is not nearly as impactful, or defensible to investors, as taking steps to increase energy performance through operational improvements. Therefore, a savvy investor should care not just about which emissions are included in the footprint, but also the source of emissions reductions and how it changes over time.

Asset-level data is key
When evaluating the carbon reduction programme for a company or fund, data availability is critical. Identifying data gaps, making estimates where possible, and having a plan to improve coverage over time are all important evaluation tools.

It’s one thing to make a broad carbon neutrality claim, but it’s another thing entirely to back up that claim with a complete data set. Access to tenant utility data can be particularly challenging, especially in a triple net lease arrangement where the tenant is paying their own bills. However, getting access to high-quality property-level data—whether through tenant outreach, metering solutions, or working directly with utilities—is necessary to prioritise improvements and track progress.

A complete data set of whole-building energy data also allows businesses to more accurately measure their GHG emissions, set and achieve meaningful carbon reduction targets, and monitor progress over time. Many core funds in this space have little access to this type of data, even as it is a key foundational element to any successful carbon reduction programme. Investors should be wary of any fund or business without access to a robust and accurate data set.

The importance of tenant engagement
On average, the total emission from a property comes mostly from tenant activities. In some instances, such as with warehouses, nearly 100% of emissions are from the tenant. But a large number of emissions reduction claims from property owners don’t account for tenant spaces by only counting certain tenant emissions or not counting these emissions at all.

While this might have been acceptable in the past, stakeholders now expect tenant activities to be captured. Some would argue that if a property owner isn’t trying to influence tenant emissions, then they are likely not carrying out an effective carbon reduction programme at all.

For any successful carbon reduction strategy, tenants must work openly and in-line with owners for targets to be met.

Engaging tenants early on—whether through a detailed survey on carbon neutrality issues or an assessment to determine what ESG considerations are most important to the tenant—will help ensure an ongoing partnership to meet stated goals for the business and tenant. Ultimately, this type of engagement helps investors and other stakeholders have a better understanding of a property’s carbon footprint.

Understanding carbon neutrality and its impact on European core real estate
Exhibit 2: Principal Real Estate- A history of responsible property investing

Principles of Responsible Property Investing
Our ESG framework for success

Market resilience
Reinforcing the social and economic vitality in markets where we do business through:
- Equitable contracting
- Community investment
- Healthy and productive buildings

Corporate governance
Managing risk and meeting investor objectives through:
- Integrity
- Transparency
- Managerial oversight

Property performance
Aiming to deliver enhanced financial and environmental performance through:
- Benchmarking energy, water and waste
- Operational best practices
- Stakeholder engagement

Recognition
What others are saying about our efforts

PRI Direct Property Assessment
A+ band ranking\(^3\)
fourth consecutive year, 2020
*highest possible rating

GRESB
4-Star rating\(^4\)
sixth consecutive year, 2021
*represents top 40% worldwide performance

CDP
A- Score or higher\(^5\)
eighth consecutive year, 2020

ENERGY STAR
Partner of the Year (2016-2022)\(^6\)
including four Sustained Excellence Awards from 2018-2022

Green Lease Leader
Gold Recognition\(^7\)
Second consecutive year, 2020

Effective programmes are a win for all stakeholders
ESG policies and initiatives, including the implementation of carbon neutrality proposals, will continue to be a top priority for investors, occupiers, and landlords. We believe the transition to a lower carbon economy begins at the individual property level and that prioritising high-impact operational emissions reductions will help create measurable change.

In addition to improving environmental performance, core funds that implement effective carbon neutrality programmes can reduce operating costs, ultimately benefitting investors. Moreover, a rapidly changing regulatory landscape, driven by the exploration of new topics such as embodied carbon, will continue to impact carbon footprints.

As this landscape evolves, we as a firm remain focused on our own sustainable business practices. These include assessing our impact to the climate and adopting responsible investing policies, as stated in our Pillars of Responsible Property Investing (PRPI) initiative.

Effective carbon reduction programmes will improve the performance and value of properties and ultimately help redefine the relationship between real estate and carbon. We believe that funds with a well-defined programme focused on true property-level emissions reduction will emerge as the beneficiaries in this environment.

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\(^3\) Performance band score of “A+” by earning 50 out of 51 maximum points in the PRI 2020 assessment. For further details, please refer to the PRI Assessment Methodology, Principal Global Investors full Assessment Report and Transparency Report, all of which is available upon request.

\(^4\) 2021 Global Real Estate Sustainability Benchmark (GRESB) assessment, data as of 31 December 2020. Rating represents top 40% worldwide performance.

\(^5\) 2020 CDP Climate Change Response, data as of 31 December 2019.

\(^6\) Each year, the EPA honors organizations that have made outstanding contributions to protecting the environment through energy efficiency. April 2022, U.S. Environmental Protection Agency. Third party rankings and recognitions are no guarantee of future investment success and do not ensure that a client or prospective client will experience a higher level of performance or results.

\(^7\) Presented by the Institute for Market Transformation (IMT) and the U.S. Department of Energy’s (DOE) Better Buildings Alliance, the Green Lease Leaders designation exhibits a strong commitment to increased performance and sustainability in buildings, 8 June 2020.
Risk Warnings

Investing involves risk, including possible loss of principal. Potential investors should be aware of the risks inherent to owning and investing in real estate, including: value fluctuations, capital market pricing volatility, liquidity risks, leverage, credit risk, occupancy risk and legal risk. All these risks can lead to a decline in the value of the real estate, a decline in the income produced by the real estate and declines in the value or total loss in value of securities derived from investments in real estate.

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