JULY 2021 | ISSUE NO. 4

STREET VIEW

Ramblings on Real Estate

ESG and Real Estate Investment...Think of it as change and risk management.

WRITTEN BY JIM GOTT

Investopedia defines ESG as:

“A set of standards for a company’s operations that socially conscious investors use to screen potential investments. Environmental criteria consider how a company performs as a steward of nature. Social criteria examine how it manages relationships with employees, suppliers, customers, and the communities where it operates. Governance deals with a company's leadership, executive pay, audits, internal controls, and shareholder rights."

This description suggests that ESG is only relevant to ‘socially conscious investors.’ Mount Street disagrees with this, partly due to our own ESG views, but mainly due to our risk management views.

The world is changing, there are many mega-trends that are reshaping the way that we live and think and it doesn’t take a rocket scientist (though we would like to think that Elon would agree with us) to work out that many of these changes are reshaping what is classed as acceptable.

To set the scene for our ESG risk views, we will borrow a couple of quotes from Howard Marks of Oaktree fame (talking about equities):

- In dealing with the future, we must think about two things: (a) what might happen and (b) the probability that it will happen.
- Valuation eventually comes into play and those who are holding the bag when it does have to face the music.

Mount Street has no doubt that within the next few years the **E**, **S**, and **G** concepts will have a far greater impact when considering investments. In part, this will be driven by climate change and in part by social change.

Why does this matter? And why does it matter now?

If we consider what *might* happen:

- ESG assessments become commonplace.
- ESG +ve assets become more attractive to investors than ESG –ve assets.
- Legislative changes required to address climate change will increase the CAPEX required for poor energy rated assets.
- ESG+ve assets will attract more tenants and thus have better yield, whilst the poor tenant attractiveness of ESG –ve assets may cause yield to drop.
- Some borrowers may become un-financeable.
- Climate risk assessment modelling could render some areas un-financeable.
- Etc.

We believe that the risk of the above happening is high, indeed it is almost certain that a number, if not all, of those scenarios, will play out.

In the worst-case situation, the outcome could be that an asset becomes stranded, or financially unviable. Re-financing may also become problematic or even impossible.

Our questions to investors are simple:

- What do you think will happen in the next five years?
- What happens if the results vs the assets that you are invested in are unfavourable?

The crux of the matter is, you don't have to think about ESG in terms of today's scorecard, but it would be wise to think about it in terms of tomorrow's risks.

FOR MORE INFO:

https://mountstreetgroup.com/

Email: info@mountstreetllp.com