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KEYNOTE INTERVIEW

Japan's office market is ready for an ESG revolution



*Japan's continued urbanization is driving real estate investment with environmental and social performance in mind, says BentallGreenOak's **Fred Schmidt**, and it makes Japan's largest cities a key focal point for imagining a more sustainable future*

Japan's urban centers continue their growth trajectory, and the many factors behind this expansion have driven global real estate investment manager BentallGreenOak to move aggressively in the Japanese commercial real estate market. With plans to invest upwards of \$10 billion in the coming years, BGO is keeping a keen eye on the evolving needs of Japan's urban population and the new and emerging demands for more stringent environmental, social and governance performance in the built environment.

BGO's Asia chairman, Fred Schmidt, talks about the challenges for sustainability in Japanese real estate,

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the importance of real estate investors and managers taking a leading role, and how technology holds the key to improving ESG performance.

Q How does Japan's continuing urbanization underpin real estate investment?

I have been investing in Japan for more than 25 years and over that period urbanization has consistently been the main driver behind our investment

thesis. In Japan, more than 80 percent of our investments have been in Tokyo and Osaka.

On any given day, in Tokyo there will be 34 million-35 million people working in the city, many of whom have commuted in from Kanagawa or Saitama or somewhere else to come to the mega-city. And of course, people continue to move from all over Japan to seek work in Tokyo and other large cities.

Q Has the covid-19 pandemic brought into question the need for people to commute to large cities to work?

There are always periods of time where

corporations explore new modes of work, but the experience in Japan continues to emphasize the value of being present in a common office environment, where the experience of on-the-job learning is still desirable. Culturally, we are observing that aspiring professionals in Japan's business environment remain drawn to learning through coaching and mentoring from senior people in a live setting.

The question then becomes: how do we strengthen the critically important workplace environment with sound practices and principles that provide an additional line of defense against the ongoing covid-19 virus or other future infectious disease events? The answer lies in our own shifting priorities as a major landlord in Japan, where health, wellness and safety are critical factors that require new forms of knowledge and new levels of investment to protect the resilience of our assets.

We utilize established, science-based frameworks to guide our approach to mitigating the spread of infectious disease and to promote health and wellness in our spaces, such as Fitwel & WELL. With one of the largest real estate portfolios in the world to be Fitwel certified, we have invested in the organizational capacity to adopt these practices in Japan.

We are actively deploying new strategies that include HVAC upgrades, filtration, ventilation, indoor air quality assessments, water quality and janitorial efficacy and these strategies will continue to be refined to support the health and wellness of occupants every day, and particularly during emergency events.

Q How will the adoption of flexible working affect office real estate?

The quality of workspace is becoming extremely important to workers from a health and safety point of view, but they also want to be in a place that is comfortable and conducive to work. Air quality is really important; people



Q Where are the easy wins for real estate owners in Japan looking to improve their environmental performance?

The key metric is lowering the carbon footprint of your portfolio and one innovation we are focusing on is using technology to manage our buildings. For example, in Japan most office buildings have separate control systems for HVAC, the elevators, security and fire. However, they are not integrated and none of them talk to each other.

We are testing software that integrates all of them so that, on a real-time basis, we can measure air quality, we can measure how the elevators are being used, how the fire and security functions are being used, etc. That information means we should be able to cut energy costs where they are not needed, thereby saving money and reducing the building's carbon footprint.

Another area is installing sensors and software which, on a real-time basis, shows you employee movement in your space and the level of CO₂. If you have high CO₂ levels, you have too many people in one space or need to move more air. I think that kind of data feedback provides a loop that gives you even more opportunity to develop space which is smarter, safer and healthier. We will implement software solutions to improve our real estate in Japan.

want it to be better and to be able to see it measured.

As flexible working often means having a workspace at home, it also means that the office is going to have to be a bit more like home, with comfortable work and breakout spaces that combine the best of both worlds into an environment built to optimize productivity. I believe that the early coworking firms had the right idea on how to include these desirable new elements to their spaces but missed the mark on managing social distancing and density issues that became counterproductive.

Owners and tenants are going to have to spend a lot more money on building or renovating to smart buildings. Japan

is the largest office market, in terms of square footage, in the world, with over 1.5 billion square feet of office space in Tokyo alone. There is a lot of work to do to make that space into the smart and healthy workplaces office workers seek and employers should offer, but I believe that we are entering a multi-year ESG revolution that will become a defining element in tenants' flight to quality real estate.

Office space is a big part of our Asian portfolio, so we have placed a great deal of emphasis on using technology to deliver what tenants need. We are seeing office rents declining where the quality of the building is not up to the standards required by tenants. We are looking at every single expense

line item in an office building and dissecting the data like never before.

Q How would you describe the attitude towards ESG issues in Japan, compared with other markets?

On a scale of one to 10, with 10 being an excellent score and one being a bad score, Japan is probably around four. We have a long way to go, especially on social and governance issues.

The industry has moved more on environmental issues because Japan is such a huge importer of oil and lacks natural resources, so the focus is driven by necessity. However, on the social front and on the governance front, the pace of change must accelerate.

At BGO, we are very involved in empowering women to take leadership roles in management positions. In Japan and across Asia, 40 percent of our staff are women with management roles and real responsibility for revenue contribution.

We are trying to do our best to help and assist in childcare and elder care, which is a huge issue in Japan, where public policy needs to be more focused. To that end, the renewal of our parental leave and family care programs align to the challenging realities of professionals today and the many lessons learned from our experience with the pandemic.

Transparency is a key aspect of ESG governance, so we report to the Principles for Responsible Investing annually and disclose sustainability performance in our annual Corporate Responsibility report. We are also a member of GRESB, and our participation in these global organizations is important to demonstrating how we are tangibly raising the bar for our clients and the tenants who look to us for clarity on these matters.

Japan is still trailing its global peers in the industrialized world as it relates to its attention to CO2 reduction and the low-carbon economy. It will take more than good intentions to bring about this shift.

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Our embrace of data-driven insights is complementing our vast on-the-ground presence in local markets to produce innovative solutions that are quickly becoming the expectation of the investor and tenant communities.

Q How engaged is the Japanese real estate industry, and where does it need to improve?

The larger real estate companies, like Mori Building, Mitsubishi Estate and Mitsui Fudosan, for example, are very focused on ESG.

With that said, we are still in the early days; it is remarkable how much more focused people are on ESG when oil goes above \$100 a barrel.

The cost of transitioning real estate to being smarter, healthier and energy efficient is substantial but once big owners implement measures and people see that tenants are moving into buildings that are smarter, you are going to see slower adopters make that change, too. A lot of it comes down to leadership and having a firm-wide vision.

Globally, the pandemic and the climate crisis have brought ESG to the forefront of the real estate industry. As a result, we have seen enhanced client, market and public demand, a rise in capital flows into ESG-themed products, and a rapidly shifting regulatory and disclosure environment that is shifting the global landscape of sustainable investing.

As real estate investment managers, we have to be leaders in this space, very simply because this is what our investors demand and that capital alignment with ESG goals is also what is going to get us to a cleaner, more resilient Japan. ■