Corporate Occupiers Podcast

Graham Rounce	Hello, and welcome to the Slaughter and May podcast. I'm Graham Rounce and I'm joined by Samantha Brady, Mark Gulliford and Ben Redding from our Real Estate Team. Sam's background is in environment and she is a key driver of the firm's ESG practice. Mark and Ben are members of our Real Estate Team and advise a range of clients on their building requirements. Between them they have a good understanding of ESG considerations for corporate occupiers. Sam, if I can start with you please. Are you able to give an indication of just how important ESG considerations have become for our clients?
Samantha Brady	Thanks Graham. Well I think it's fair to say that our whole client base has been ramping up its efforts in this and has been doing so for the last couple of years. So, some of that is obviously being driven by legal requirements and policy, but it's really the voluntary initiatives where we see the real drivers for change. So that can be whether you're setting science-based targets, like we have as a firm, or integrating the UN sustainable development goals or going that step further and integrating the recommendations of the task force on climate-related financial disclosures which has to really happen at both the operational level and the commercial and corporate mind set. But the way that our clients occupy buildings is actually a real challenge within this, sort of, general decarbonisation journey and that's because commercial and industrial buildings, they account for a large percentage of the greenhouse gas emissions from buildings within the UK. So, just looking at that there's 1.66 million commercial buildings in the UK and they account for a third of the emissions from buildings. And that's why the commercial builds environment has to be a key focus for the Government and for the sector and it's really encouraging to see that the commercial builds environment is a key theme at COP26 this year. Generally, our clients are occupying buildings as tenants and that, in itself, provides some interesting challenges because they're having to look at the building, you know, for its fit for purpose, for its operations, they're having to think about the building as part of their ESG impact but the actual business will also be part of a wider supply chain and there will be stakeholders within that supply chain who will be putting pressure on the corporate occupiers to reduce

	their environmental impact and carbon footprint because that in turn will reduce the carbon footprint and environmental impact of the much wider supply chain. And that's going to get more interesting as companies are having to report on and assess their broader environmental impact of may be a product that they provide, or a service that they provide. And for corporate occupiers who are tenants, they can't do this alone and they need the right degree of support, information sharing co-operation with landlords. And at the moment that's still very much frame around the E in the ESG. So there may be reports of energy use, there may be reports on even embodied carbon, in more sophisticated building set ups. But, there will have to be a move away from just looking at E. There's going to be a big drive towards looking at the S in terms of use of buildings.
Graham Rounce	Thank you, Sam. That's really interesting. It really does feel like that this is now something, that's on everyone's agenda. Turning next to Mark. Mark, the social impact of buildings isn't a new thing is it? But are we seeing more client-led initiatives?
Mark Gulliford	I think that's right, Graham. It's definitely not a new thing and actually you can go back to, sort of, the 1890s and find people like Cadbury's constructing villages with a very defined social purpose connected with their wider business. And then social contribution has been an important part of the planning system for a long time also. So, section 106 agreements used to engage things like contributions to local infrastructure, transport, public realm improvements and so on and, obviously, affordable housing which is a huge part of the planning system. More recently, we're seeing things like the community infrastructure levy. So funding very specific infrastructure investment in London, for example, Crossrail and there are more reforms proposed for that. But I think what we're seeing from our clients is perhaps the social impact being an earlier part of the thinking in terms of the purpose of a particular development. And also clients thinking about how they align some of that to their broader corporate strategy. So whether that's developer clients thinking about their impact, in particular, communities or whether that's corporate occupier clients thinking about how they use the buildings that they occupy and their links with a particular area for a social purpose.
Graham Rounce	Great, thank you very much, Mark. That's really interesting again showing this has been around for some time, but what I think we're now seeing is a rapid acceleration in the evolution of ESG.

	Ben, turning to you. I know you've been involved in some recent lettings for clients. How exactly has the ESG manifested itself on these deals?
Ben Redding	Thanks, Graham. I think it's fair to say ESG has become a real headline issue for many businesses when they're looking at moving headquarters. And, in many ways, that shouldn't really be a surprise. As Sam mentioned, ESG is now a board level issue and a tenant's HQ is usually the epicentre of its business. It has its large numbers of its staff there, it brings clients, its stakeholders and investors there. So it is imperative that the building that they're moving to reflects the tenant's commitments promoting ESG. But what has actually been really interesting from the matters where I have acted, is how clients are now really focussing on the E, S and G of ESG. For a long time, I think, the E of ESG had been the part of the equation in the spotlight but now clients are really starting to focus on and delve down into all three of these. In respect of the E of ESG, we are still seeing energy efficiency ratings but we're also seeing such things as landlord commitments in respect of achieving certain air score ratings and ventilation rates. Which obviously are a direct result of COVID. Landlord commitments both during the construction phase of the building and its operation to divert minimum amounts of waste from landfill. And also commitments both from landlord and tenant in respect of promoting a circular economy. I think in terms of the E it is fair to say that clients no longer see its successful simply to say, "oh this building's got an EPC rating of A, so therefore it's a green building". I think tenants now do just want more. In respect of the S of ESG, I'm really starting to see clients question how its building can make a positive social contribution. Whether this is by making the building or a stage available for local community groups; targets in respect of local employment, which obviously originates through the planning system, or even things as seemingly simple such as ensuring that people providing services to the building are paid the London living wage. These are all things tenants are now looking at and starting to question. I think tenants are also starting to think about how they make their offices places their staff wants to be in – we'll come on to talk about this later. What facilities does the building have? Does it have adequate bike and changing facilities? What's the quality of those facilities? Does the premises allow for collaboration, a sense of community. Ultimately, is the premises somewhere that the staff want to be in and want to come to work? And finally on the G of the ESG, we are seeing a heightened importance on both the landlord and the tenant side to maintain a continual open dialogue. Property lawyers will be familiar with leases containing provisions in respect of setting up environmental working committees for buildings but I think in reality, in times gone

	by, whilst these committees existed on paper, the truth is they didn't really exist in reality. I think these days are behind us. I think buildings will now have active ESG committees where both the landlord and the tenant are fully engaged and just on that point of kind of engagement and collaboration, it is vital that both landlords and tenant engage on these ESG issues because a lot of what we're talking about and what the three of us will talk about today simply wouldn't be possible unless there's a coherent partnership between the two.
Graham Rounce	Great, thank you very much, Ben. I couldn't help but feel a lot of what you were talking about related to perhaps some of the larger deals, new developments, state of the art, HQ, perhaps central London, dare I say it. But what about the wider market, what about the wider London market, the regions. Do you think some sort of two tier market is developing?
Ben Redding	Absolutely, and I think this will only become more pronounced over the coming years. I think for all occupiers, large and small, those buildings that are lagging behind will just simply become less and less desirable but I think the two tier market is true from both the landlord and the tenant side. I had an interested statistic a few weeks ago that with the leasing deals over the last two years that have achieved is the highest rents, 80% are on buildings that have achieved a BREEAM rating of very good or above. There was also some recent research from Knight Frank that the London office buildings they've achieved the highest standards and sustainability can achieve up to a 12.3% premium rent. Now, look while this clearly doesn't show the full picture, it certainly gives you an idea that tenants will pay a premium for a sustainable building. Now for new builds it's relatively easy or, I should say, easier to set up aggressive ESG agenda because you're starting from a blank slate. But it's more difficult for existing assets that may be slightly older. And for these buildings landlords will need to work with their tenants to consider how they can be improved. It may be that landlords need to invest their own money to improve the buildings but ultimately landlords will need to consider in the long term whether not investing is something they can really afford to do.
Graham Rounce	Great, thank you very much, Ben. Sam, returning to you, Ben has given an indication of some of things he's come across on, as we said, the larger deals but also mentioned that, a little bit harder perhaps for some of the older buildings, and also goes to the value inevitably, what is in the

	Government's armoury to ensure a wider application and do you think we will see increase statutory intervention?
Samantha Brady	So, Graham, the existing armoury is diverse but unfortunately I don't think it's fit for purpose at the moment for really for dealing with the climate change emergency in respect of the use and occupation of commercial buildings. It's very much focussed on carbon and greenhouse gas emissions and not broadly at ESG improvements. The general theme at the moment is very much getting at buildings to make them nearly zero energy, and that's very much focussed on the kind of high energy performance. So that comes from the form of the building regulations and the relevant energy efficiency requirements that are set out in that. And then for existing buildings you've got your energy performance certificates. So that's the rating that a building needs to be given before it can be sold or let. And then on top of that we're seeing, you know, the increasing MEES requirements, so the minimum energy efficiency standards, whereby landlords are just simply not permitted to let buildings that are substandard from an energy efficiency perspective. And then at the macro level, the Government is required to produce a much longer term renovation strategy for dealing with existing building stock because as I said at the beginning of this podcast, that's, you know, the real challenge in the UK. It's not about the new buildings that are being produced, it's about well what do we deal, how do we deal with the existing building stock and make that fit for purpose from a, kind of, environmental standards perspective. And that's why I think there's going to be a real driver for change in the form of looking at how we actually assess buildings and in order to therefore come up with something that means that you can assess them properly, you can then include a framework for driving improvements in the relevant ratings of buildings. So, at the moment, buildings are very much assessed on a, kind of, theoretical basis. So, how should a building perform from an energy efficiency viewpoint? And that's looking at the building just at its, you know, its materials, its systems etc. What it doesn't do, and this is key, is look at how the building is actually going to be occupied on a day-to-day basis. And so the Government is looking at introducing a scheme which is very heavily borrowed from the Australian Neighbours' Scheme, whereby a building is assessed in terms of how it performs with that relevant occupier in situ. And then once that kind of way of assessing a building and giving it a rating has been developed, you know, I can see a real drive for there to be, kind of, benchmarking and for requirements to improve the ratings of the buildings. In, very much, in a similar way to what we've seen with the minimum energy efficiency standards. I think

	it is really important as well that this is going to be part of a mandatory scheme if it is introduced and it's going to be in a very much a phased way so for buildings initially it will be offices over a thousand square metres. And they are the buildings that tend to be more sophisticated and it, there isn't always a correlation between how a building is rated without looking at its occupation against how a building is rated with its occupation. But this will provide the Government, but also investors and landlords and tenants with a much better way of comparing buildings and, at the moment, there just simply isn't that same like for like comparison out there.
Graham Rounce	Great, thank you, Sam. So, clearly more to come, watch this space. Mark, it's fair to say, I think, that ESG is definitely the flavour of the month and, if I may say so, this feels a lot more positive subject after months and months of COVID-19 and before that Brexit. But what does ESG actually mean in the context of a client's property estate?
Mark Gulliford	I think we've obviously talked a lot about the sustainability angle to all of this, and I think that's going to continue to be the main focus for most of our corporate clients in terms of their occupation of buildings. What does that mean practically? Well, particularly in the context of leased estates, it's going to mean a lot more collaboration with landlords. Data is something that is talked about a lot and for some years now we've been talking about the importance of landlords having access to data on things like energy use within a building. What I think we're starting to see is that becoming more of a two-way thing. So, actually corporate occupiers are themselves interested in how buildings are performing. And hopefully that then develops into people thinking about how things can be made more efficient. And maybe even the commercial rationale for shared investment in buildings and that's a tricky topic to get right. There's a clear tension between a landlord with a long term ownership of a building and the tenant who perhaps has a much shorter term interest but I think increasingly there is a rationale for thinking about how there can be shared investment and making a landlord's base build work with a corporate occupier's fit out for example, to ensure efficiency in operation and not just initial construction. Obviously that links to design and perhaps that moves a bit into some of the other topics that are going to be important in this space. Things like wellness, which relates to issues like building ventilation, also building connectivity and flexibility. And on the more social side, thinking perhaps about building use and the interaction of buildings with the surrounding area. We've seen actually in the pandemic the huge impact of buildings being empty

	and how that's effected surrounding businesses as a whole ecosystem in the City for example, which has been very quiet over the last eighteen months. And I think, as people move back into office occupation, and indeed in other sectors, the S, the social impact of buildings is going to continue to be important as corporate occupiers think about how they relate to businesses around them, their supply chains and their employees.
Graham Rounce	Thank you very much, Mark. Latching on a little bit to what you were talking about at the end, that's on everyone's lips around the coffee shops in the City, talking about plans for coming back to the office, different strategies. Ben, if I can return to you please on that subject. Employees are clearly a huge part of this, so just how important is the ESG angle as clients/employers start considering their strategies for the return to the office?
Ben Redding	Yes, very, Graham. As I said earlier the office has got to be a place where employees want to be. This is why I think in terms of both, the tenant's choice of building and the tenant's fit-out, the interests of employees are being taken into consideration. I think most of our clients, as part of a headquarters relocation, will consult with their employees about what they want from the new offices, what facilities they would like, how they would like the offices set-out: open plan, cellular, collaboration spaces. Now, I'm not saying employers will be pleased to hear this that every single ask or want of employees is being accepted but it's now not simply the case that a handful of executives select a building, decide the fit-out then just tell their employees where they're going. If the last eighteen months has shown us anything, is that a large number of employees are happy working from home and if employers are to attempt, kind of, employees back to the office at whatever frequency that is, the office has got to be somewhere employees want to be so the voice of employees has to be heard. On the actual, kind of, ESG credentials, I was speaking to a client the other day, who we're currently acting for, and she was reviewing some of the ESG drafting we had suggested in the lease and she said "this is great, our employees will expect this". And that to me says everything. It is isn't just corporately the business wants to support an ESG agenda but actually the management of the business recognises that their employees expect it and it's a selling point of business to both the current employees and to potential future employees.
Graham Rounce	Great, thank you very much, Ben. It's certainly nice to see a lot more people back in the City that's for sure. Mark, looking a little bit wider, clients clearly can't do this on their own. To what extent do you think lenders are starting to get in on

	the act, and also, how important is Government investment in the necessary infrastructure?
Mark Gulliford	Well, we've already touched a little bit on how some of this impacts on value of property and from that perspective it is clearly going to be of interest to lenders as well. I think for a long time sustainability provision and the like have been a bit of an add-on in diligence even from a technical perspective perhaps lower priority has been the energy efficiency. Now as that becomes very crucial to value it's going to be more important to lenders and actually, the ability to access data, the ability to carry out surveys and to carry out upgrade works, are all going to be really important and that clearly has an impact on corporate occupiers as well in terms of what they can expect from property owners. More broadly than that, there's obviously a whole topic and we don't have time today to go into it, around green finance, green bonds, green loans with lenders lending, expecting very particular targets to be met. Expecting that funds to be used in a particular way and to meet certain ESG targets. And in terms of Government intervention, there are a number of different initiatives and Sam's touched on some of the regulatory framework that's relevant here. I think we'll continue to see that develop and we'll continue to see Government trying to incentivise the right behaviours and also setting up frameworks that allow some of this to be measured and allow a degree of accountability so that people can be working to common standards and hopefully that allows for more effective action in some of these areas.
Graham Rounce	Great, thank you, Mark. So Sam, ESG is clearly now relevant right across the board and is at the heart of corporate planning, but how can clients measure and report on their progress in this area?
Samantha Brady	Well clients definitely don't need to wait until all of these requirements become mandatory in terms of how buildings are assessed or what you need to report as part of your wider corporate reporting. If you take this at, sort of, what clients can do now, if you're looking at it at a building level, there are various voluntary accreditations around and, you know, they're helpful in that they set a framework to allow all the relevant data to be collected and assessed and looking at what improvements can be made and making sure that the building is considered very much from a holistic perspective. So, you can't just look at what the energy usage of the building is, you've also got to look at things like well, what are the materials made out of that are being used in buildings? Particularly where there's been alterations to the building further

	through the life stages of the building. And then at a more corporate level, I mean we are seeing many of our clients adopting the task force on climate related financial disclosures as a framework, and the importance of these frameworks is really the way that they bring all the different parts of the business together. So that's whether the people looking after the property portfolio, the HR team, the insurance team, the treasury. And I think it's a really exciting time really for clients because it is allowing them to, kind of, take stock and see what they're already doing, what they can build upon and making sure that what they're already doing receives the right amount of attention within the business and therefore seeing what else can be done. So there are different, you know, it's not as if there's one size fits all, there's different ways of designing these schemes and frameworks but it's something that can definitely be done now, and should be done now. We can't just simply wait for the Government to require certain reporting to be carried out.
Graham Rounce	Thanks very much, Sam and also as we approach the end of this podcast, thank you also very much to Mark and Ben. These are certainly interesting times and clearly buildings and corporate occupation is very much at the heart of it. Can I before we leave just ask each of you for one key takeaway? Ben, if I can start with you please.
Ben Redding	Yes, absolutely, Graham. I think from all the HQ matters I've worked on, my one key takeaway is that no one party can do this alone. In order to allow any building to achieve its full ESG potential, there has to be collaboration and partnership between the landlord and tenant or tenant and developer. And as part of this partnership, there needs to be an acceptance that ESG is constantly changing and evolving. So, what may be the gold standard today may not be so in a year's time. It may be appropriate in the future to set different or higher targets. I think both parties need to be willing and open to this in order for all buildings to hit and continue to hit their ESG potential.
Graham Rounce	Thank you, Ben. Sam?
Samantha Brady	For me, the important thing is that the environmental impact and broader, sort of, carbon footprint of a building, that shouldn't just be thought of at the design stage, a building can be occupied for many years, it can have many different occupiers but there is this sort of general lifecycle of a building and it's important that the ESG considerations are considered at each stage so that's the design, the occupation and the alterations right through to the demolition and that's why I think it's really useful and interesting that the

	industry bodies are considering how to carry out assessments of the lifecycle of a building.
Graham Rounce	Thanks, Sam. And last, but by no means least, Mark.
Mark Gulliford	I think from my perspective, sometimes we talk about these topics, there are a whole range of initiatives regulations, it can feel perhaps overwhelming as a corporate occupier with limited resources to dedicate to the buildings' estate. How do you make sense of all of that? Well, I think aligning your efforts to broader corporate purpose is really important. All organisations, kind of, know what they stand for and know what they're trying to achieve and their buildings are often a huge part of the business and perhaps can be used in a more effective way to align to that, whether that's for environmental purposes or social purposes. So, I think that's the challenge, but also one of the ways of making sense of these desperate topics is to think about how all of this fits in with the businesses' broader corporate purpose.
Graham Rounce	Thank you, Mark. As we approach the end of the podcast, can I just thank everyone for listening and please feel free to speak to one of us or your usual contact at the Firm for more information.