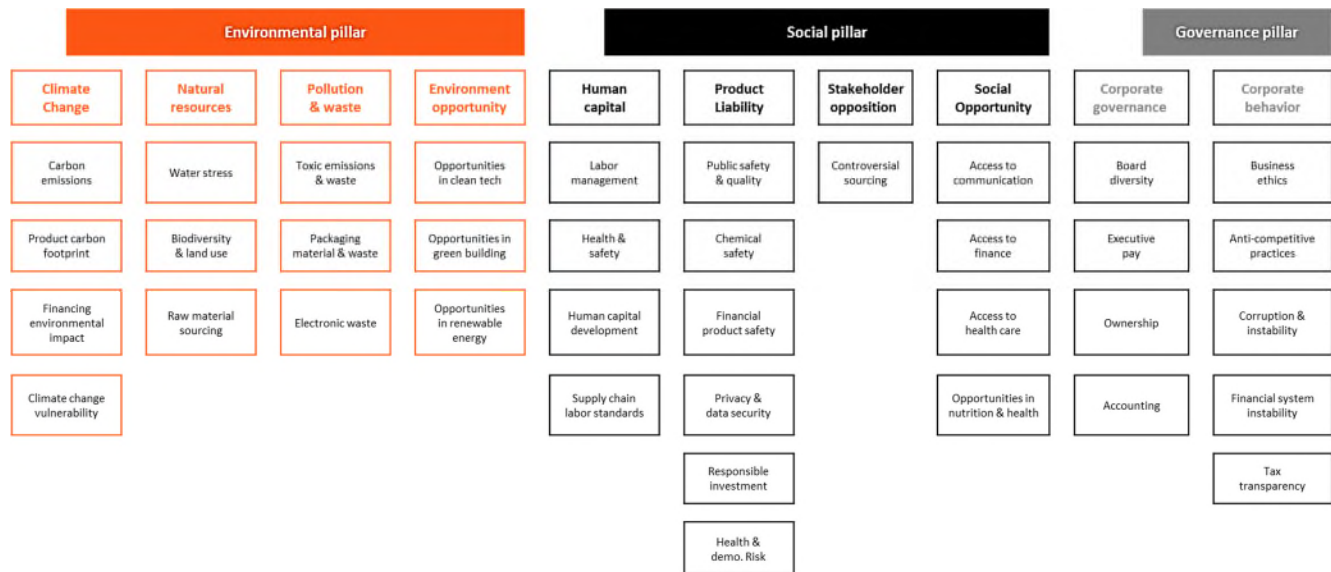


**10<sup>th</sup> Annual Green Infrastructure Conference**  
**Wednesday, October 19, 2022**

**PANEL 2: ESG IN COMMERCIAL REAL ESTATE DEVELOPMENT**

**I. BACKGROUND**

**A. The ESG Landscape**



**B. What is ESG**

- Environmental, Social, Governance
- Set of non-financial criteria used to evaluate companies – internally and externally – and to manage business risks and opportunities
- Business purpose beyond ethical/social considerations
- “G” relates to how companies are governed
- “E” + “S” relate to how companies operate
- Vast topic covering large number of risks

**C. Scope of ESG**

- ESG has become an all-encompassing term, but, in essence, ESG is a set of considerations companies should monitor and measure in order to best serve a growing set of stakeholders
- As the term becomes more expansive, companies can struggle to maintain focus on the objectives and metrics that matter most to their core business, particularly

as stakeholders and other observers pressure firms to “do the right thing” on a host of issues

## II. ESG IN REAL ESTATE DEVELOPMENT

### A. How to Implement ESG into each stage of a project



### B. Constituents

#### Internal constituencies

- Boards
- Management
- Employees
- Shareholders

#### External constituencies

- Business partners
- Investors
- Lenders
- Tenants/Customers
- Consumers
- Competitors
- Communities
- Government agencies

## III. GOVERNANCE PILLAR

### A. Basic Concepts

- Governance encompasses (1) corporate governance and (2) corporate behavior
- Substantial empirical evidence suggests strong governance yields better returns
- “G” is the effective management of an enterprise and strong “G” is necessary to have effective “E” and “S” programs
- Board and executive level oversight of ESG risks and opportunities – “tone at the top”
- Strong “G” ensures effective integration of ESG into decision-making, internally and externally

- Includes how management (1) communicates ESG factors that are important to the business and its goals, and (2) implements and oversees ESG program
- Particularly important for long-term assets like real estate

#### **B. Examples of G (Internal) Practices**

- Practices that promote compliance with laws, ethical company behavior
  - compliance programs
  - whistleblower protections
- Practices that promote corporate culture
  - “tone at the top”
  - code of ethics
- Practices that promote employee wellbeing and workplace experience
  - Diversity, Equity & Inclusion
  - business resource groups
  - COVID-19 response, work from home
  - internal pay equity

#### **C. Examples of G (External) Practices**

- Incorporating ESG into each stage of deal and property lifecycle
- Development of inclusionary/exclusionary criteria for CRE deals
- Requiring ESG-related questionnaires from borrowers, vendors, investors
- Systems for measuring and goal-setting ESG-related operational and financial performance (diversity, energy/water consumption, health sustainability, tenant stability)

### **IV. ENVIRONMENTAL PILLAR**

#### **A. Environmental Factors**

- Properties in the U.S. exposed to sea-level rise sell at a 7% discount compared with similar properties with less exposure
- Environmental issues represent the top three global risks to RE investment: (1) extreme weather events; (2) failure of climate-change mitigation and adaptation; and (3) natural disasters
- Increased interest in LEED-certified office space for CRE tenants

## **B. Key E Issues for Commercial Real Estate**

These issues should be considered in each stage of the deal and property lifecycle:

- Energy efficiency/management
- Climate change adaptation
- Water management
- Greenhouse gas (GHG) emissions
- Impact on environment

## **C. Climate Change Adaptation/Resiliency**

Sea-level rise may cause:

- Direct damage to properties
- Supply chain disruption
- Costs associated with infrastructure-related remediation projects
- Making unavailable property insurance or increased costs of (1) property insurance, (2) real estate taxes or other assessments, (3) energy and water, and/or (4) property maintenance
- Decreased business continuity at properties
- Declining demand for office space in buildings

These risks should be treated as financial criteria

## **D. Examples of E Opportunities**

- Energy efficient construction
- Incentives to use renewable energy
- Infrastructure improvements
  - Electric vehicles
  - Walkways and bikeways
- CRE companies can highlight the ESG attributes of its projects
- Questionnaires to collect E policy and performance information
- Exclude properties in areas with increased forest fire activity
- Property Management implementation of recycling programs
- Link company's borrowing costs directly to achieving its E targets

## V. SOCIAL PILLAR

### A. Social Factors

- Includes how companies relate to employees, suppliers, customers and communities
  - Diversity, Equity and Inclusion
  - Environmental justice
- Increasingly, CRE buyers, lenders and investors are considering the social impact of CRE

### B. Examples of S Considerations

Though the “S” Pillar is not front-and-center for real estate investment, social considerations may still animate diligence, underwriting and origination practices:

- Limiting exposure to properties or borrowers with high-ESG risk
- Increased deployment of capital to underrepresented communities or opportunity zones
- Attention to sourcing of labor and supplies for development and other CRE projects
- Healthy buildings

### C. Limiting Exposure to ESG Risks

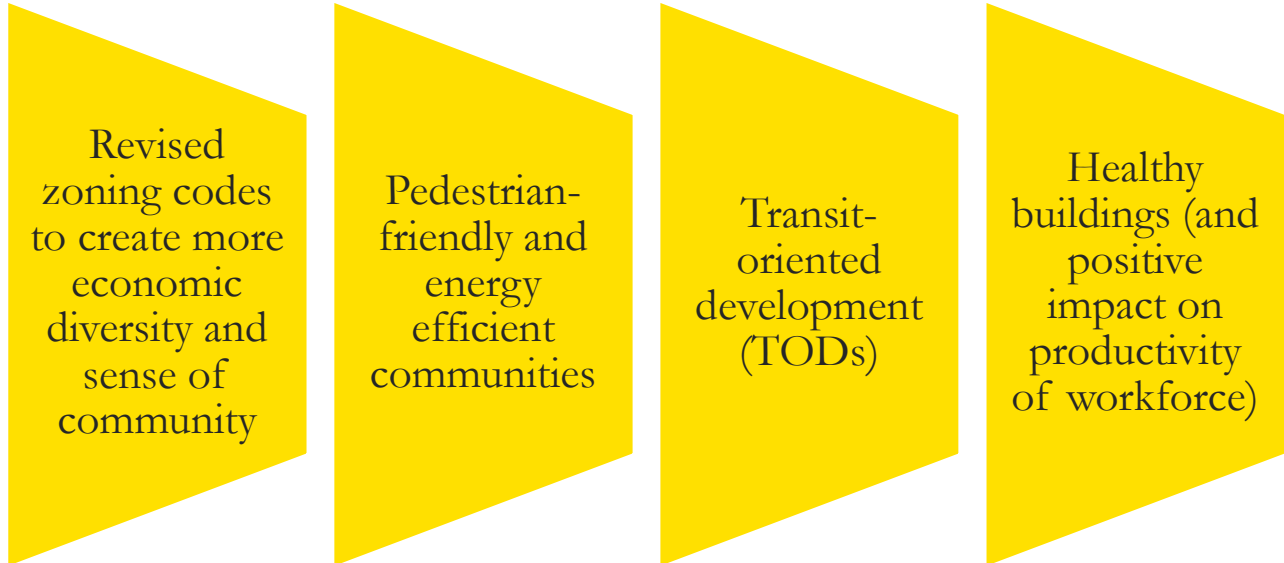
- Underwriters/originators to be thoughtful about the long-term sustainability of projects/borrowers
- Whether a company may be susceptible to social or reputational damage because of the nature of its business can play a role in CRE decisions
  - Oil, gas, and mining
  - Drug manufacturing
  - Payday lending
  - Anti-money laundering (AML)

### D. Deployment of Capital

- Companies are also making pledges to ensure that some portion of their capital are dedicated to projects that serve a broader social purpose, including providing housing or retail options in underserved communities
  - Affordable housing
  - Women and minority owned businesses

- These commitments require a holistic look at the real estate portfolio, and resources to ensure quality funding opportunities

#### **E. Community Development/Design**



#### **IV. ADDITIONAL ESG CONSIDERATIONS**

- Increased data collection and reporting
  - Sustainability Reports
  - Corporate Responsibility Reports
  - ESG Reports
- Regulatory frameworks
  - SEC proposed major climate disclosure rule
  - Labor Department proposed rule on ESG retirement investing re climate change
- Formation of industry-specific organizations to help establish ESG investing principles and reporting guidelines
- Insurance companies are using ESG as a factor in underwriting
- Inflation Reduction Act of 2022 includes tax credits and deductions to incentivize investments in clean energy technologies and reduction of carbon dioxide emissions