

Sustainable sustainability in real estate

Impacting long-term value measures:

1. Environmental

2. Social

3. Governance

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With climate change, income inequality and social justice front and center in daily headlines, real estate stakeholders are demanding greater transparency as it relates to how companies interact with and impact the communities in which they operate. Investors, regulators and society as a whole are looking to assess these nonfinancial measures to determine the true long-term value of a company. Environmental, Social and Governance (ESG) is gaining prominence with respect to investment decisions and the determination of capital allocations, especially with regard to the global real estate industry. But how are organizations meeting these expectations while also meeting the bottom line?

Impacting the Environmental pillar of ESG

Public and private efforts are reducing the energy consumption needs of a growing population

The construction and operations of buildings have been shown to account for 40% of worldwide greenhouse gas (GHG) emissions,¹ and with such a massive carbon footprint, nations, local governments and companies are continuing to set carbon reduction goals with an eye to becoming as carbon-neutral as possible.

In New York City, the Mayor's Office has launched a public-private partnership to decrease GHG emissions for commercial buildings by at least 30% over the next 10 years as part of the effort for the city to reduce GHG 80% by 2050.² To achieve these goals, companies are sourcing energy from renewable resources and using new technologies and data analysis to aid in reducing energy consumption, waste diversion programs, and decreasing water usage through efficiencies and conservation. Reducing emissions not only reduces carbon output but also provides long-term value by reducing energy costs, creating operational efficiency and extending the useful life of building systems.

Businesses such as our own Ernst & Young LLP (EY US) are also announcing major efforts to reduce their carbon footprint. In April 2019, EY US shared that it had entered into renewable energy virtual power purchase agreements (VPPAs) to initiate the construction of two large-scale Texas-based wind farms. The wind farms are scheduled to be operational by mid-2020 and are expected to generate enough zero-carbon electricity to offset the absolute GHG emissions of our US business. "These agreements actively address the environmental impact of our business and will become the cornerstone of our low-carbon strategy, yielding significant economic and risk mitigation benefits," said Leisha John, EY Americas Director of Environmental Sustainability.

Other entities, such as US-based equity REITs, have issued more than \$3 billion of green bonds since the summer of 2018, which finance new or existing projects that are meant to have positive environmental or climate effects. According to the nonprofit Climate Bonds Initiative, the global green bond market hit a milestone in 2019 when new issuance surpassed \$100 billion. All things being equal, if faced with the choice of investing in or issuing a regular bond or a green bond, many investors are opting to invest in a green bond.

¹ Greengage Environmental. "Comprehensive Carbon Footprinting in Real Estate." GRESB, (2018, November 26). <https://gresb.com/comprehensive-carbon-footprinting-real-estate/>

² The New York City Carbon Challenge. (2017, January 26). <https://www1.nyc.gov/html/gbee/html/challenge/mayor-carbon-challenge.shtml>



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Industry sector examples

Within the construction industry, building sustainable and energy-efficient structures is essential to business success. Offering homebuyers environmentally conscious features like rooftop solar panels, LED lighting, improved insulation and smart-home technology plays well in the eyes of both the consumer and investor as it's both intentional and measurable (e.g., lower utility bills, reduced water usage, renewable solar energy).

There is also a growing interest in zero energy buildings (ZEBs), and several countries have adopted or are considering establishing ZEBs as their future building energy targets to help alleviate the problems concerning the depletion of energy resources and the deterioration of the environment. Two such design strategies involve minimizing the need for energy use in buildings (especially for heating and cooling) through energy-efficient measures (EEMs) and adopting renewable energy technologies (RETs) to meet the remaining energy needs.

Physical retail is going through vast disruption as consumers want experiences, not just things. So, what are the benefits of employing strategies like designing retail space to maximize the use of daylight, enhancing greenery, installing LED bulbs and electric vehicle charging stations, and improving public transportation information to encourage customers to use greener transit to and from the store? For starters, the discerning customer will pay attention. According to a report by the [Retail Industry Leaders Association](#), an estimated 68 million adult Americans base purchasing decisions on their values – personal, social and environmental – and say they will spend up to 20% more on environmentally sound products. In March 2018, a Quebec City-based retailer opened a first-of-its-kind store in its home city designed to generate as much energy on-site as it consumes annually, with an aim to reduce overall greenhouse gas

to the atmosphere. The store's parking lot includes 133 spots that have canopies covered in 1,020 bifacial modules with glass on both surfaces to capture direct and reflected sunlight. When combined with an impressive 2,308 bifacial modules on the roof, the entire solar electric system will generate over 1,300,000 kWh/year – the equivalent to about 50 typical Canadian homes.³ Natural light, clean air and environmental consciousness are better strategies for setting the mood and increasing a store's foot traffic than loud noise and thumping beats amped up over the sound system. The enjoyment and satisfaction of in-store retail consumers and employees may result in higher satisfaction ratings and greater revenues, particularly in a down market.

Q What environmental initiatives will help your organization's sustainability and brand aspirations?

³ <https://www.retail-insider.com/retail-insider/2018/3/la-maison-simons-quebec-city-galeries-de-la-capitale>

Impacting the Social pillar of ESG

Companies are increasingly interacting with and positively impacting their employees and the communities in which they operate. Investors, regulators and society as a whole, are progressively looking to assess these nonfinancial measures to determine the true long-term value of a company. Organizations that are meeting these expectations, while also meeting the bottom line, are reaping the rewards and distinguishing themselves from the competition.

Public and private efforts

Leading public and private organizations are developing innovative programs that are simple, effective and powered by eager volunteers who want to give back to their community. A team of EY Assurance and Tax professionals recently joined 17 of their owner/operator client colleagues and coated 17,000 square feet of rooftops at two Bronx apartment buildings as part of the NYC Cool Roofs program. NYC Cool Roofs is a collaboration among NYC Service, the NYC Department of Buildings and the Community Environment Center to promote and facilitate the cooling of New York City's rooftops. Through their efforts, the EY and owner/operator client volunteers reduced the roof temperatures by approximately 30 degrees and significantly lower electricity usage for cooling on the upper floors of each building. Further, it is estimated that CO2 emissions will be reduced annually by 17 cubic tons as a result of coating the two buildings.

Beyond the type of local volunteering in the example above, many employees of companies are also leveraging organization-wide volunteer efforts that make a significant, coordinated impact across one or more of their region or country locations. [EY Connect Day](#), for example, is our annual day of service and our largest signature volunteer program held on a single day. It's a time to celebrate our purpose of building a better working world by building inclusive teams, expanding networks across service lines and ranks, learning new skills and having some fun. Since our first EY Connect Day in 2010, EY professionals have logged over 770,000 hours, strengthening our communities across the Americas. Additional volunteer efforts continue throughout the year and are led by local champions.

At a global level, our new global Corporate Responsibility program, [EY Ripples](#), will help us to make a greater social impact by providing our people the opportunity to use their skills, knowledge and experience to positively impact the lives of millions of individuals. As a business, we'll be further embedding principles of responsibility, sustainability and inclusive growth in our own operations and throughout the EY value chain to demonstrate that we meet the highest standards of ethical business.

Through EY Ripples, we focus on supporting the next generation and working with impact entrepreneurs. By working with these groups, we apply our skills where they can make the biggest difference, extending the value of EY knowledge, networks and services to people we might not otherwise reach. This is the first step on a multi-year journey to positively affect the lives of millions of people. Because when 270,000 EY people feel inspired to start ripples-and theirs merge with those of other like-minded people and organizations-we can create huge waves of change.

Companies are also focusing on community involvement partnerships with not-for-profits that align with their businesses, such as disaster relief programs, housing support, and job assistance and training programs. Employee participation initiatives have also become key to providing a strong bond with the community and a greater sense of community for their employees, particularly with millennials, who show increased loyalty to companies that care about their effect on society. These programs can lead to greater satisfaction from customers and happier employees, increasing profits and decreasing employee turnover.

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Impacting the Governance pillar of ESG

Governance aspects of sustainability provide structural support to the ways in which organizations interact with and positively impact the environment, their employees and their communities.

Corporate citizens across the globe are under the microscope more than ever in terms of how their policies impact people and to show that **profits do not come at the expense of their people**. These people, including employees, customers and their community at large, are becoming more responsive to the companies around them. In today's world of instant news and social media, negative press coverage can be extremely detrimental to a company's bottom line from boycotts to investor pushback. Governance and the related policies, procedures and processes that are documented and ingrained into the organizational culture are critical to mitigating these risks and help to ensure "sustainable sustainability" over the long term.

Establishing and building upon formal programs

Companies are increasingly focusing on establishing or building upon formal programs in areas such as employee wellness, investing in expanded health care, flexible work arrangements, maternity- and paternity-focused programs, and expanded counseling programs including mental well-being, financial planning and career planning.

Leadership, oversight, operations and performance of these and other programs are crucial to being successful both financially and as corporate citizens as they increase stability, transparency, and employee retention. It's paramount to have the proper processes, protocols and policies in place to monitor these programs, and success results when a diverse group of executives leads them. Instituting the correct tone at the top shows an organization's commitment to transparency, accountability and actions that are in line with sustainability and responsible social policies.



If you are doing it, report on it

Many real estate companies are already including ESG information as part of their investor and public reporting and include numerous key performance indicators, including energy usage, GHG emissions, waste management (recycled and composted vs. landfill), number of LEED or Energy Star assets, and employee mix data, among other metrics. In addition to providing reporting for their stakeholders, companies participate in a variety of external reporting programs including the Global Reporting Initiative, LEED, Energy Star, Nareit and others, allowing the industry to compare and benchmark its progress as well as spotlight and recognize leaders in the field. Although currently voluntary, the number of companies that provide ESG information grows every year and conceivably one day soon will be a requirement as opposed to an option as investors place greater importance on these nonfinancial measures.

Hotel owners and operators have emerged as natural born leaders in the sustainability conversation. In the summer 2019, ULI released its Greenprint Report, which highlights best practices that the hospitality sector has implemented to increase energy efficiency, conserve water and reduce waste. No longer is it acceptable to rely upon those dubious signs in the bathroom that ask hotel guests to consider reusing their towels in an effort to help the environment. Compare and contrast the water used in hotel swimming pools (less than 1% of hotels' water usage) to that which is used in hotel bathrooms (30%), and it becomes obvious why one prominent asset manager opted to upgrade bathroom fixtures, including toilets, faucet aerators and showerheads, throughout its hotel portfolio. This move resulted in a demonstrable 500,000 gallons (18.9 million liters) of water being saved across its portfolio. An innovative move within hospitality might be to use gamification techniques to boost hotel guest engagement, and at the same time, invite them to participate in the sustainability conversation by raising awareness of the benefits of recycling and waste reduction.

Industry and governance organizations getting into the act

Another important barometer to consider is the growing ESG guidance and award programs sponsored by highly respected real estate industry organizations. For example, each year Nareit issues an award to the member REIT that has demonstrated superior and sustained sustainability practices. Real estate companies committed to sustainability are demonstrating that operating and developing commercial real estate can be conducted with a conscious regard for the environment. In 2019, Nareit also **issued** its inaugural guide on ESG Reporting Frameworks to help its members better understand and navigate the array of ESG reporting frameworks.

In November 2018, the Sustainability Accounting Standards Board **codified** standards by sector, including real estate, to identify, manage and communicate to investors sustainability information that is financially

material. The standards were designed to help investors by encouraging reporting that is comparable, consistent and financially material, thereby enabling investors to make better investment and voting decisions. Key disclosure topics include energy management, water management, management of tenant sustainability impacts and climate change adaptation.

Q What kind of governance is your organization putting into place to help promote successful sustainability and brand initiatives?

Investing for impact in the real estate sector

Impact investing approaches correlate profitability with sustainability, and ESG information helps mitigate downside risk for organizations, which can be especially attractive during a market downturn and times of economic uncertainty.

Impact investing

Investment in climate change has moved a long way since the signing of The Paris Agreement in 2015, but challenges and opportunities remain. Bill and Melinda Gates noted in their 2019 annual letter that “if we’re going to solve climate change, we need to get to near-zero emissions on all the things that drive it – agriculture, electricity, manufacturing, transportation, and buildings.”

In addition to capturing the attention of prominent philanthropic organizations like the Gates Foundation, socially responsible investment managers have begun to launch real estate impact investment funds. There has also been a rise in the number of pension funds looking to invest in such strategies. In the US, sustainable, responsible and impact investing (SRI) assets grew by as much as 38% from 2016 to 2018, according to the Washington, DC-based membership association US SIF Foundation’s 2018 report, which found that SRI assets now account for \$12 trillion of the \$46.6 trillion in assets under professional management in the US.⁴



Affordable and workforce housing are among several of the many asset classes that have the potential to achieve measurable social and environmental benefits combined with financially rewarding investment performance. Still, it will take a lot of change and innovation to make ESG a central priority.

A potential accelerator could be to target the smaller retail investor looking to participate in syndications of individual real estate projects – made possible these days by the democratization of real estate, the availability of big data and financial technology, also known as FinTech. But still, the Goliath-sized real estate fund managers that target institutional-grade investors will need to remain a driving force in the ESG conversation as half the respondents to the PERE ESG Investor Survey 2019 indicated that they would not invest with a manager who does not have a defined ESG policy.⁵ Although in that same survey, only 6% of its participants said it was easy to measure the correlation between the strength of a fund manager’s ESG policy/initiatives and the investment return they are seeing. Another 23% responded with “very difficult” and 45% said, “we do not perform this analysis.”

The survey also found that 35% of investors already require private real estate firms to implement ESG initiatives, with 13% making this a requirement over the next three to five years.

Opportunity Zones

Opportunity Zones, created through the Tax Cuts and Jobs Act, are census tracts primarily located in low-income areas that were nominated by states and subsequently designated by the IRS as “qualified opportunity zones.” A replay of our archived webcast is available online. While it is unclear whether the program will spur jobs and economic development, Opportunity Zone-based projects have the potential to incorporate green initiatives, such as clean energy and sustainable development, in the 8,700-plus zones designated across the nation. Time will tell whether the attraction of capital gain tax deferral and partial forgiveness of additional gains on investments in Opportunity Zones will attract patient capital and deliver higher returns to investors while simultaneously making an impact with their investment dollars.

⁴ <https://www.perenews.com/why-impact-investing-is-gaining-ground/>

⁵ <https://www.perenews.com/perere-esg-investor-survey-2019-eight-takeaways/>

The “ultimate” customer experience

Leadership in Energy and Environmental Design (LEED), a green building initiative that aims to help building owners and operators be environmentally responsible and use resources efficiently, has partnered with the International WELL Building Institute, a public benefit corporation whose mission is to improve human health and well-being in buildings and communities across the world through its WELL Building Standard™ (WELL™). LEED and WELL are working together to demonstrate that green building and health and wellness go hand in hand. This partnership plays a prominent role in addressing the Environmental Protection Agency’s statistic that Americans spend a staggering 90% of their time indoors. As employers continue to focus on attracting and retaining appropriate talent, they are increasingly placing emphasis on their employees’ physical health and well-being. WELL Building Standard focuses on seven concepts: air, water, nourishment, light, fitness, comfort and mind.

WELL Certification has the prestige of enhancing building owners’ employee experiences, service offerings to its occupants and daily wellness operations. It can be achieved for virtually any property type, including hotels, multifamily, office buildings and even coworking operators. In fact, coworking operators are demonstrating leadership in this area by working collaboratively with property owners to introduce sustainability-driven health and wellness solutions into buildings. For example, a leading flexible workspace enterprise has partnered with a primary care provider to offer an onsite health-care facility that extends not only to its members but also to the non-member tenants who reside within the building. Earlier this year, a premium flexible workspace enterprise partnered with a global lifestyle brand to offer workspaces co-located with its fitness club locations. In 2018, a Boston-based coworking company was awarded WELL Certification in recognition of its smart heating, cooling and lighting systems, energy efficiency and water conservation, healthy materials, finishes and furniture, and environmentally safe cleaning products. By working in partnership with landlords to curate the “ultimate tenant experience,” coworking operators are trending as fast movers in the wellness conversation and demonstrating how the social merits of a robust ESG strategy can produce intentional outcomes – that is, more efficiently operated buildings that appeal to occupants, lease faster and command higher rents.

The value of ESG information in a market downturn

As noted by Mathew Nelson, EY Global Climate Change and Sustainability Services Leader, “ESG information plays an increasingly important role in the investment decision-making process, and respondents believe that ESG factors can help mitigate downside risk. Nearly all respondents (96%) say that such information has occasionally (62%) or frequently (34%) played a pivotal role in decision-making.” According to testimony at the Urban Land Institute’s 2015 Fall Meeting in San Francisco, financial institutions view efficiency improvements as having a demonstrable impact on future profitability. As a result, they are more willing to underwrite buildings that offer these kinds of retrofits.

In the world of irreversible consequences, more will need to be done to raise awareness of the benefits of ESG and sustainability, of the detriment of not leaning in on the topic of socially responsible investment choices, and of the leadership role that real estate stakeholders – developers, property owners, investors, regulators, lenders and users – must take in the conversation.

Learn more, do more

Ernst & Young LLP’s Climate Change and Sustainability Services practice has a new podcast series discussing leading trends and practical advice around environmental, social and governance issues and opportunities facing businesses today. [Click here to listen to current and archived episodes.](#)

To learn more about our 2019 CEO Imperative Study and how investors and boards expect CEOs to respond to humanity’s greatest challenges, [click here.](#)

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