A Slow-Moving Train

The commercial real estate industry is engaging in sustainability initiatives, although implementation remains mixed.

By **Beth Mattson-Teig**

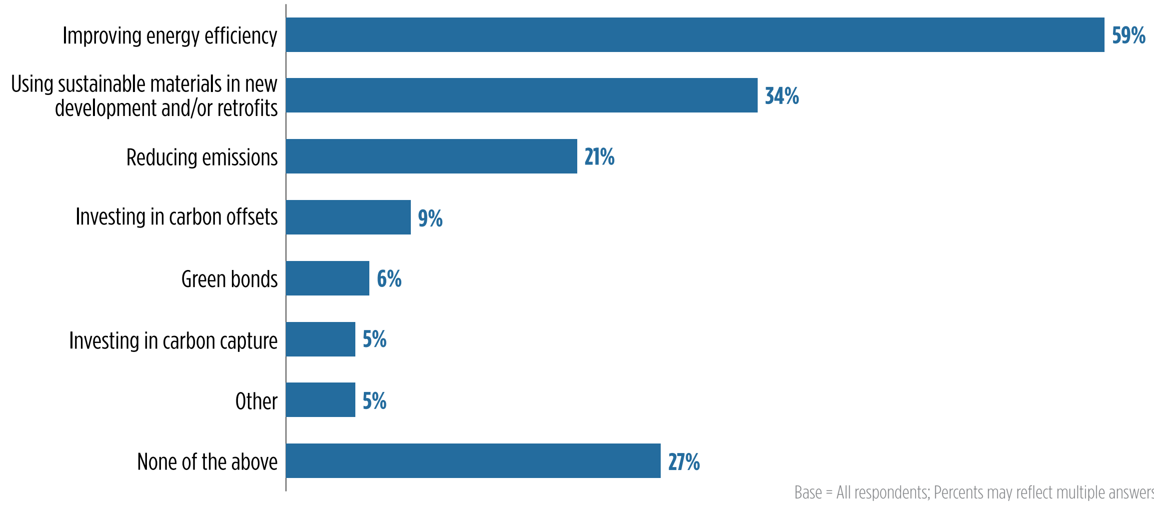
Green building has been gaining momentum over the past two decades, and greater focus on climate risk and ESG initiatives are providing additional tailwinds for sustainable initiatives. However, results from the latest *WMRE* research show there remains some reluctance in moving to a greener commercial real estate market.

A healthy majority of survey respondents, 73 percent, said they currently have implemented sustainability strategies at least at some of the properties they own and/or manage. "The industry has definitely progressed over the last 10 to 15 years around sustainability," says Eric Tilden, PE, LEED AP, director of energy and sustainability at Cushman & Wakefield. More owners are not only working to improve sustainability at the property level, but they are more focused on the impact of energy consumption and carbon emissions on climate risk. A growing number of institutional owners also are setting ambitious net zero carbon goals. That said, the industry does have a long way to go in order to meet goals outlined by The Paris Agreement, which calls for limiting global temperature increases this century to less than 2 degrees Celsius, he says.

"While I would love to see a higher number, that 73 percent number is not far off from what I would expect in terms of industry adoption," adds Josh Richards, director of asset services at Transwestern. One reason that number is not higher is that some smaller owners are less motivated, or even less able, to invest in sustainability due to the incremental cost. Meanwhile, other property owners are more "unintentionally green" than they think they are, he says. Larger municipalities are increasingly embedding components of LEED standards into new building codes. So, any developer that is building to code is building to a more sustainable level than they did 20 to 30 years ago, and they may not even realize it, notes Richards.

Power Play

Energy efficiency is the most common area CRE owners and managers are focused on.



Base = All respondents; Percents may reflect multiple answers

Reducing expenses and emissions

The most common sustainability strategy utilized by 59 percent of respondents is energy efficiency measures, which is followed by the use of sustainable materials in new development and/or retrofits at 34 percent; and reducing emissions at 21 percent. Other strategies used by a minority of respondents are investing in carbon offsets at 9 percent, green bonds at 6 percent and investing in carbon capture at 5 percent.

The fact that energy efficiency tops the list for sustainability strategies is not surprising as it has the most rapid payback. Depending on the scale of the project, the payback on energy efficiency measures can range between two and 10 years. "For most investors, that is wildly appealing, because you can see the return on your investment very quickly," says Richards. Reporting platforms such as EnergyStar also make it very easy to see the quantifiable results of those energy efficiency measures. "I think energy efficiency will continue to be a major push. It is certainly the easiest for us to convince owners to invest in it," he says.

Leading architecture and design firm Gensler is seeing significant interest from clients across industries in pursuing energy efficiency strategies. "The next step is to tackle embodied carbon—emissions related to the entire life cycle of building materials, from harvesting and manufacturing to transport and construction," says Andy Cohen, co-CEO of Gensler. Buildings generate some 40 percent of all emissions each year, between operations and embodied carbon. Embodied carbon in particular accounts for about 11 percent of total emissions annually, and that proportion is growing as building operations become more efficient, notes Cohen. "The structural components of a building are responsible for a significant proportion of initial embodied carbon emissions. So, opting for renewable and sustainable building materials like wood, instead of concrete and steel, can make a tremendous impact," he says.

Interior finishes and furnishings are also significant contributors to a building's carbon footprint, due to the churn of replacing them over the whole lifetime of a project. Gensler designers are not only specifying more sustainable products in buildings, but they're also creating them, such as furnishings that are designed for disassembly, that are made from recycled materials, and that can be reused or recycled once they're no longer needed. "The real estate sector in the U.S. is definitely making progress, but there is still so much opportunity for taking leadership as we move toward a more resilient and sustainable future," says Cohen.

Energy efficiency is top priority

When asked to rate sustainability priorities, improving building energy efficiency ranked as the top priority. On a scale of one to five, 65 percent of survey respondents rating improving energy efficiency as a four or a five. Incorporating sustainable materials in new development and/or retrofits rated as a priority for 41 percent, followed by reducing building carbon emissions at 30 percent.

Setting priorities is especially important for property owners and managers who are continuing to advance ESG strategies and net zero carbon goals. "Energy efficiency is the first thing you can tackle when you start to come up with a net zero target. So, that is absolutely on my list," says Anne Peck, vice president and head of ESG+R at TA Realty, a leading provider of real estate investment management services with about $12.3 billion in AUM. Peck was recently hired to lead development of the firm's measurable annual ESG+R goals and drive implementation of their corresponding roadmap at the corporate level to ensure integration of ESG+R through-

out the company and across the assets it manages.

"Carbon offsets and carbon bonds are very important to the overall industry. The problem is there is less of an ROI with those. So, you don't actually see the impact that you are doing on the rest of the world," notes Peck. "That's why it is less favorable, although it is definitely still a piece of it, and everyone has to whittle away with as many pieces as possible." Sustainable materials also are important, but the cost of those materials is a factor, because projects still have to pencil out, she says.

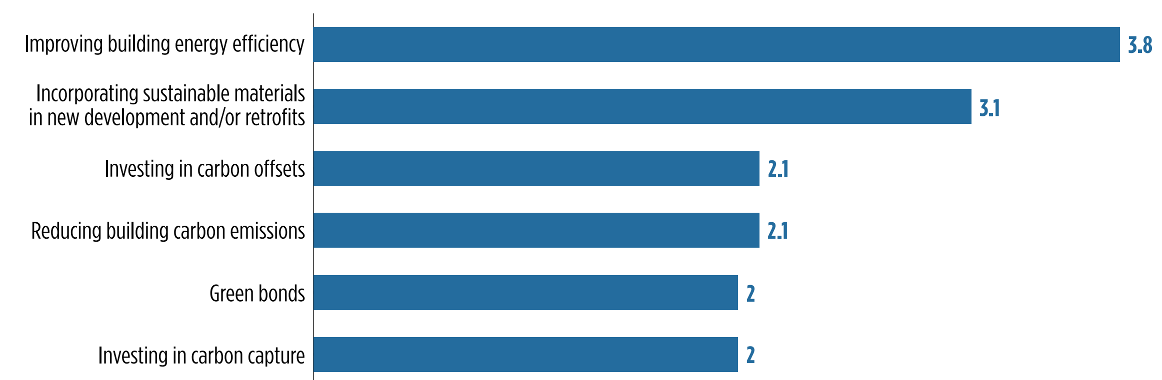
Investing in carbon capture and utilizing green bonds rated as a low priority for nearly half of respondents. Only a minority 15 percent and 13 percent, respectively, rated carbon capture and green bonds as a four or five. Those results are not surprising as carbon offsets are often used by owners that are looking to bridge the gap to achieve net zero carbon, which is still a fraction of the overall market. Carbon offsets also tend to generate mixed views. Although there is real value to offsets in supporting green projects, a lot of people think of them as an "easy button", says Richards. In theory, a property could make no reductions to energy, emissions and water consumption, but they can announce that they have reduced consumption by 30 percent YOY simply by buying offsets.

Room for improvement in certifications

A growing number of building owners are looking for a quantifiable green stamp of approval through industry certification programs such as Leadership in Energy & Environmental Design (LEED), EnergyStar, the WELL Building Standard and Building Research Establishment Environmental Assessment Method (BREEAM). As evidence of that growing demand, there are currently 75,547 LEED-certified commercial and residential buildings in the U.S.—about 85 percent of which

Top Priorities

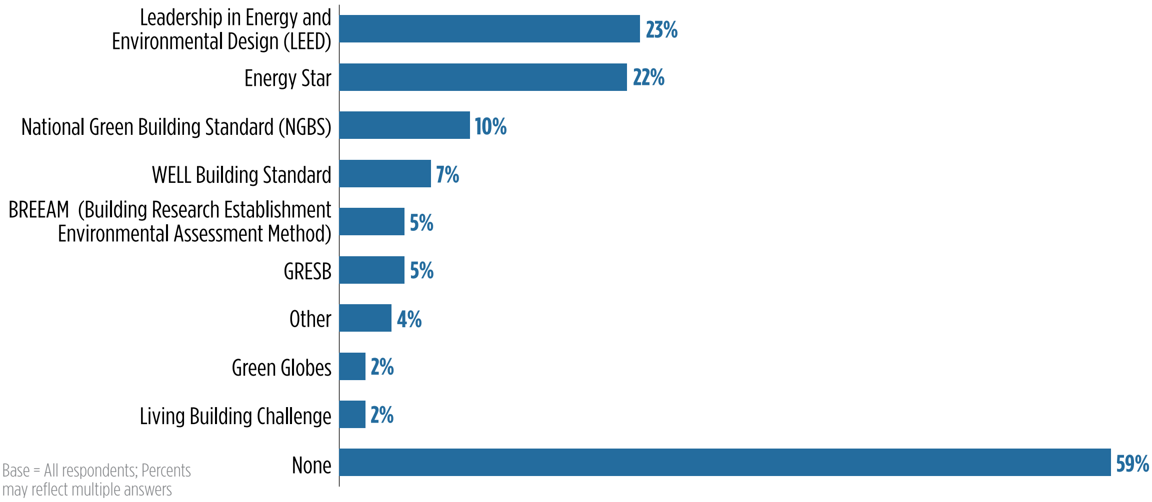
Sustainable Initiatives, 1 = Low priority, 5 = High priority



Base = All respondents

Certification Adoption Remains Low

A majority of respondents have not pursued any of the major green certifications for their buildings.



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have been certified in just the past decade, according to the U.S. Green Building Council.

"The LEED movement has been growing progressively and is frankly table stakes for many tenants that are leasing space and investors that are investing," says Byron Carlock Jr., national partner and real estate practice leader at PwC. Buildings that are not LEED certified or don't have a rating from the WELL Building Institute are at risk of becoming more difficult to lease, finance or attract investors. The key word in the discussion on sustainability is relevance for the future, adds Carlock. "The relevance question will continue to be monitored closely, which is why we are seeing an increased focus on reporting standards," he says. PwC has a growing segment of the company devoted to ESG assurance audits and corporate social responsibility reports that are now being attached to financial statements. In Europe, that is a requirement, whereas in the U.S. it is voluntary for now.

Four in 10 respondents report having pursued green building certifications for their properties, most commonly LEED (23 percent) and Energy Star (22 percent). Those doing so report an estimated mean 36 percent of their portfolio holds one or more green certifications. In addition to LEED and EnergyStar, industry participants also are reporting increased interest in WELL and Fitwel, which blend green building with health and wellness aspects. In, addition, there has been an uptick in demand for BREEAM.

"I was surprised at the 40 percent number," says Tilden. The response to EnergyStar also was surprisingly low as EnergyStar is almost a "must have" that is widely used by portfolio managers for benchmarking and reporting. "It is probably the most fundamental of the green building certifications in the U.S," he says.

Building material decisions can also affect green rating certification, with low-carbon structural materials contributing to overall certification scoring.

"The environmental advantages of using wood products are recognized by most green building certification systems, but they vary in how wood use is credited. With two of the most well-known programs, LEED v4 and Green Globes v1.4, it is possible to earn 8 to 10 percent of potential credits through substantial use of wood in construction," says Ryan Flom, chief marketing officer of the Softwood Lumber Board.

Stakeholders, costs influence certifications

Climate risk and extreme weather events are pushing sustainability issues more to the forefront for the built environment, which is broadly credited with producing an estimated 40 percent of greenhouse gas (GHG) emissions globally when accounting for the impact from both construction and operations. However, there are a myriad of other internal and external forces at play. When asked what factors most influence commitments to green building at their properties, the environmental impact resonated with the most respondents at 39 percent, followed by investor expectations at 35 percent, state or local mandates at 31 percent, tenant demand at 27 percent, current ESG mandates at 20 percent and forthcoming ESG mandates at 19 percent.

Companies such as Google, Amazon and Target have made their own commitments to ESG, which is further pushing real estate owners to up their game if they want to attract those tenants. "In my opinion, we've grown leaps and bounds over the last two years as an industry just talking about sustainability and ESG. That is mainly due to investors asking questions about it and wanting complete answers," says Peck. In the past, investors were starting to ask about ESG, but they didn't necessarily understand what the answer was that they were looking for. Today almost all major investors are asking questions, and they expect certain answers. So, the industry had to move from providing a "check the box type of response" to action at the asset level to make their portfolios more sustainable, she says.

When asked what factors impact an owner's decision NOT to pursue green building standards for properties in their portfolios, more than half of respondents (54 percent) said that costs were too high. Other factors that were important for many respondents were lack of tenant interest (28 percent) and lack of investor interest (25 percent). Factors that trailed more distantly, each at 17 percent, included lack of information on how to implement green building standards, views that green building standards are ineffective, and no government mandates requiring green building standards. Additionally, 12 percent said that green building standards are not necessary.

Another factor that could be contributing to the low percentage of respondents that reported pursuing LEED certifications is that, in many cases, it is easier to pursue green building certifications in a ground-up development versus a retrofit or redevelopment. "When it comes to our older building stock, a lot of our owners are at a decision point," says Richards. Do we keep the core and shell and do a major renovation? Do we keep the major building systems and do piecemeal upgrades over time? Do we keep things in place and upgrade as we get new tenants moving in and out? Or do we demolish the building and build a brand new one? A lot of people are waiting to see how things play out in the economy and especially the demand for office space in the post-COVID market before making big decisions on new cap-ex projects, he adds.

Evolving investment strategies

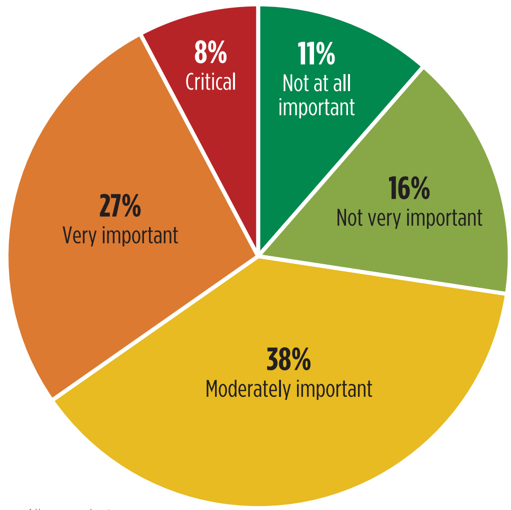
Survey results do show that sustainability is an important consideration in both operations and investment strategy. Thirty-five percent of respondents said that environmental sustainability is critical or very important in their acquisition and/or development decision-making process. Another 38 percent believe it is moderately important, while less than one-third (27 percent) consider it to be not very or not at all important.

"Last year and this year were the awakenings that ESG at all levels—the E, the S and the G—are keenly important to the industry," says Carlock. That sentiment was evident in the PwC and ULI Emerging Trends in Real Estate 2022 report. Eighty-two percent of respondents in that report said they are making decisions today based on climate and ESG issues, whether that is where they buy, how they underwrite and how they think about their assets. "That is the highest number that we have ever seen. So, I think we can say that the industry has really taken on this sensitivity," he says.

In the U.S., many cities and states are enacting net zero legislation with Boston becoming the latest city to pass an ordinance that sets emissions performance standards on existing buildings with the goal of decarbonizing the city's large building stock by 2050. Those new requirements—and fines for those properties that don't comply—is going to force owners to consider transition risk for their assets.

Somewhere in the Middle

Respondents were asked how important environmental sustainability was in acquisitions and/or development decision-making processes.



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For some owners, those issues are just beginning to hit their radar. For example, a study of buildings in New York City found that a majority of buildings would comply with Local Law 97 initially without making any changes or new investment. However, the compliance requirements tighten every five years.

Owners are starting to do analysis to determine how they are impacted now; how might they be impacted 15 years from now; and what can they do today to mitigate the impact in 2030. How expensive is this going to be for me as an owner to comply with these new standards around greenhouse gas emissions? Is it worth buying a core building knowing that they may have to pay for fines for noncompliance or a costly retrofit, or figure out a way to pass those costs on to tenants?

"Is it affecting decision-making right now? No. Is it going to next year? Probably a little bit more. Is it five to 10 years from now? Absolutely," says Tilden. "Everyone I talk to is saying that ESG will contribute to my decision-making more in the future, and we are at the beginning of that transition for a lot of owners." ■

Survey methodology: *The WMRE research report on sustainability was conducted via an online survey distributed to WMRE readers between October 12 through October 21, 2021. The survey results are based on responses from 224 participants. Respondents represent a cross-section of different roles in the commercial real estate industry, including investors, building owners and managers, developers, lenders, brokers and financial advisors. A variety of job titles and positions are represented within the respondent base with the largest being the C-suite at 34 percent.*