CUSHMAN & WAKEFIELD

SUSTAINABILITY MEGATRENDS

Navigating the Most Recent Developments in the Commercial Real Estate ESG Landscape

Introduction

A recent 2023 study revealed that the global environmental, social, and governance (ESG) adoption rate of investment professionals considering ESG factors in their strategy reached 90%—an upward trend from previous years.[1] The impact of climate change only continues to escalate after all, and investors, regulators and consumers are increasingly scrutinizing the ESG performance of real estate companies and portfolios as a result.

The Harvard Business Review speculates that companies will be more resilient in the face of unexpected shocks and hardships if decisionmakers consider sustainability megatrends over the long term.[2] Both internal and external stakeholders are demanding progress and enhanced transparency in ESG activities, yet the ever-evolving field of sustainability presents challenges in keeping up with trends and effectively executing strategies. Navigating this landscape requires continuous adaptation to achieve meaningful advancements toward ESG initiatives. This article explores emerging ESG megatrends, expectations, and strategies to navigate the complexities of corporate sustainability in commercial real estate (CRE).

[1] Capital Group ESG Global Study 2023 | Capital Group

[2] Social-Impact Efforts That Create Real Value (hbr.org)

MEGATREND 1

INSTITUTIONAL INVESTMENT IN ESG

ESG Megatrends to know

Institutional Investment in ESG

Institutional investors are showing increased demand for properties with strong ESG-related management and activities. Investment in opportunities that align financial returns with positive social and environmental impacts have proven to increase overall returns. A survey of 250 institutional investors worldwide found that 60% of respondents reported that ESG investing resulted in higher performance yields and 78% said they'd pay higher fees for ESG funds.[3]

Several approaches exist to integrate ESG into investment strategies. Some firms may systematically factor in ESG impact based on companies' reporting on ESG topics, among other investment criteria. Moreover, sustainable finance approaches directly tie financing into ESG projects and outcomes, such as Sustainability Linked Loans (SLL), which correspond to ESG performance, and Green Bonds, which fund sustainable projects. The property sector accounted for over 8% of the sustainable finance market in 2022, reaching $127 billion.[4]

60%

OF GLOBAL INVESTORS REPORTED THAT ESG INVESTING RESULTED IN HIGHER PERFORMANCE YIELDS

78%

OF GLOBAL INVESTORS SAID THEY'D PAY HIGHER FEES FOR ESG FUNDS

[3] ESG-focused institutional investment seen soaring 84% to US$33.9 trillion in 2026, making up 21.5% of assets under management: PwC report

[4] Real estate and finance sectors must collaborate to meet Australia's climate goals | Green Building Council of Australia (gbca.org.au)

Sustainability linked loans make up approximately 90% of global sustainable lending. These can be used by REITS to secure loans with more favorable terms by reporting and meeting the specified Sustainability Performance Targets. For example, Manulife, a Cushman & Wakefield partner, obtained a five-year $250 million SLL connected to its green building portfolio. Manulife benefits from interest rate reductions linked to sustainability targets to allow for borrowing costs savings and a positive environmental impact.[5]

This emerging demand for ESG investment presents an opportunity to differentiate your portfolio and improve borrowing terms. Thirty percent of investors surveyed reported difficulty finding attractive and adequate ESG investments and 88% of survey respondents believe asset managers should proactively develop their ESG programs. [6]

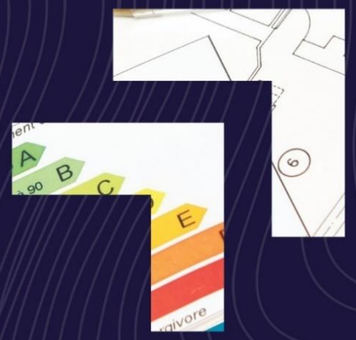
By capitalizing on this "trend," not only can you distinguish your real estate portfolio, but you can also meet the growing expectations of investors to enhance your competitive advantage across the market.

OF INVESTORS SURVEYED REPORTED DIFFICULTY FINDING ATTRACTIVE AND ADEQUATE ESG INVESTMENTS

[5] The rise of sustainability-linked loans in commercial real estate (cim.io)
[6] ESG-focused institutional investment seen soaring 84% to US$33.9 trillion in 2026, making up 21.5% of assets under management: PwC report

MEGATREND 2

BUILDING PERFORMANCE STANDARDS



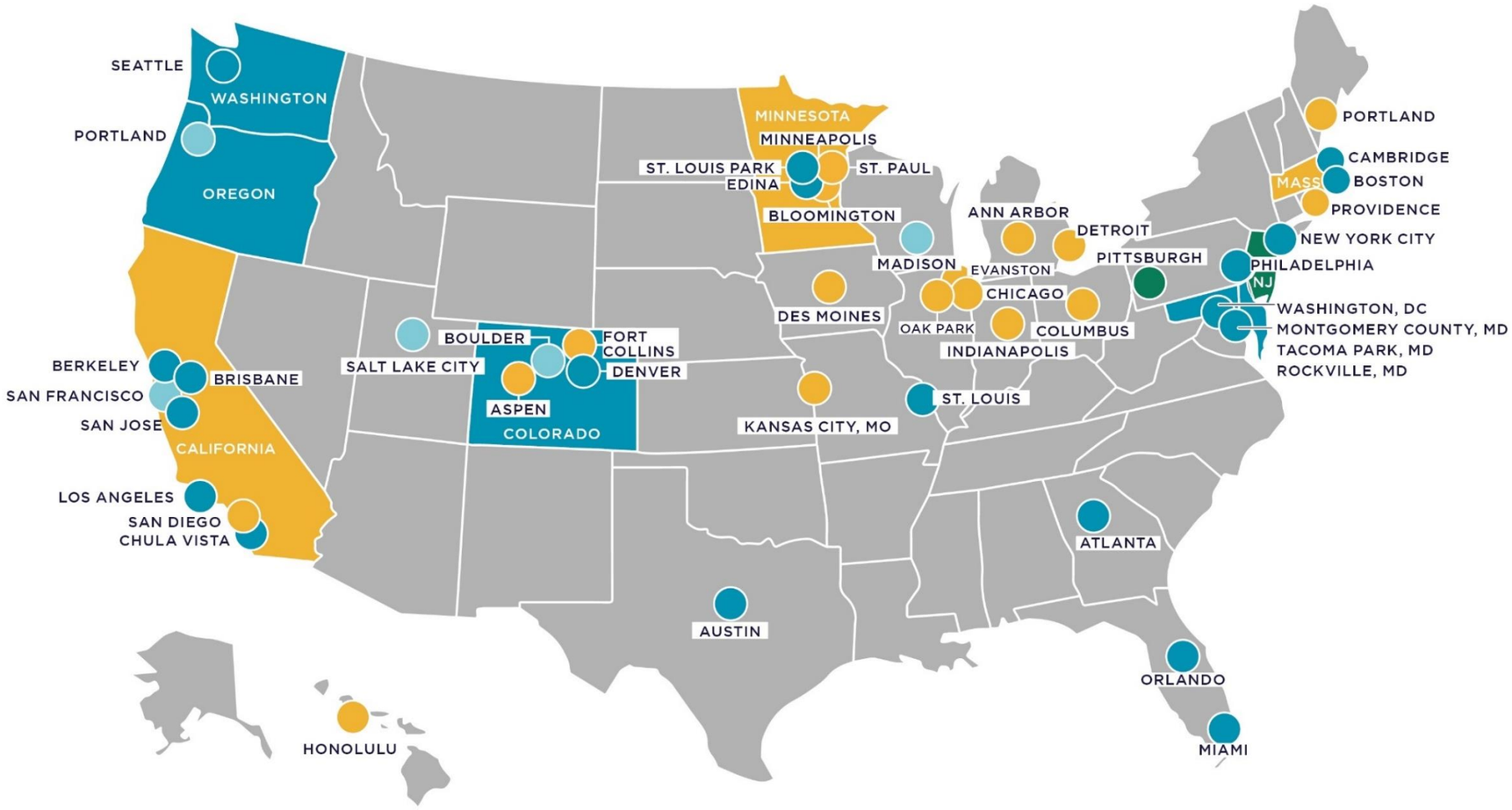
Building Performance Standards

Legislation is a key tool to mitigate the environmental impact of building emissions and increase awareness of climate-related risks. The prevalence of building performance standards (BPS) and reporting requirements are rapidly increasing at the local, state, and federal levels.

The National Building Performance Standards coalition comprises a nationwide group of state and local governments committed to developing energy consumption and/or GHG emissions standards. The jurisdictions with BPS policies passed or in progress represent around a quarter of the buildings in the U.S. and are only growing.[7] If your company's portfolio is not yet impacted by environmental regulation, it is likely to be soon.

[7] National BPS Coalition - National BPS Coalition

U.S. City, County and State Policies for Existing Buildings: Benchmarking, Transparency, and Beyond



One example of BPS in action is the Building Energy Performance Standard (BEPS) ordinance in Washington, DC, which requires commercial buildings of over 50,000 square feet (sf) to meet enhanced performance standards.

When The Westory, a 273,000 sf office building, subject to Washington, DC BEPS compliance, engaged C&W's Energy and Sustainability Services team, the result was a 29% reduction in energy consumption compared to the 2019 baseline and a 24-point increase in the building's ENERGY STAR® Portfolio Manager score.

By identifying and implementing no- and low-cost energy conservation measures such as adjustments to existing programs, equipment scheduling, off-hour operational reviews, and additional capital measures, The Westory not only met but exceeded Washington, DC BEPS requirements.

MEGATREND 3

MANDATORY ESG REPORTING

Mandatory ESG Reporting

It's critical for owners and property teams to remain abreast of the regulatory landscape to avoid associated penalties, understand the carbon footprint of their assets, and proactively manage their compliance. Mandatory ESG reporting is another prevalent regulatory tool to push building owners to understand and take accountability for the environmental impacts of portfolios. Government entities may require building performance benchmarking and climate-related disclosures, maintaining a high level of transparency. The specific requirements may vary but often include some combination of reporting energy consumption, GHG emissions, and climate-related risks associated with the asset or portfolio.

The list of jurisdictions requiring ESG reporting is growing. Currently, 49 cities and six states have mandated a form of ESG benchmarking and disclosures for commercial real estate properties. At the federal level, the Securities Exchange Commission (SEC) recently passed rules to enhance and standardize climate-related disclosures on March 6, 2024. While these final rules are pending legal review, they will require public companies to disclosure climate-related risks and include relevant greenhouse gas emissions information in annual reporting.[8]

[8] SEC.gov | SEC Adopts Rules to Enhance and Standardize Climate-Related Disclosures for Investors

MEGATREND 4

ENERGY TRANSITION + DECARBONIZATION

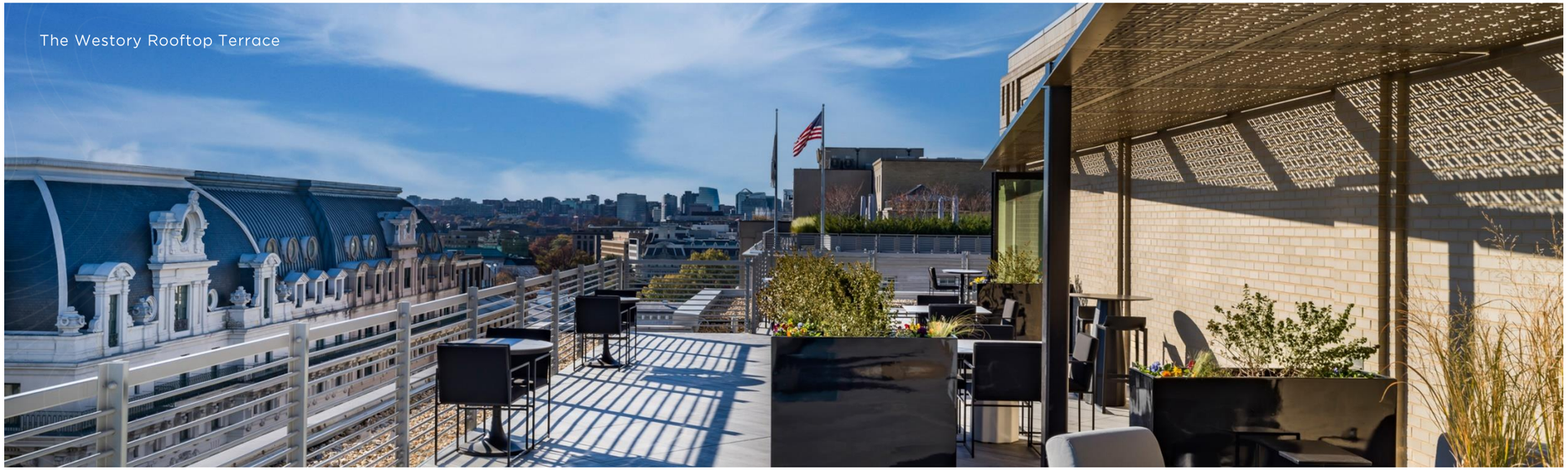
Energy Transition and Decarbonization

Buildings account for approximately 40% of global greenhouse gas emissions with Scope 3 emissions specifically representing up to 90% of a company's emissions, according to the Carbon Disclosure Project (CDP).[9] Consequently, Scope 3 emissions, which encompass the indirect emissions across a company's supply chain, play a crucial role in the total carbon emissions of the real estate industry.

[9] CDP-technical-note-scope-3-relevance-by-sector.pdf

More and more, CRE companies and stakeholders are recognizing the importance of addressing these emissions impacts and exploring strategies to target their sources, as demonstrated by the thousands of companies reporting Scope 3 emissions to frameworks like CDP and those participating in the Science-Based Targets Initiative (SBTi). The Greenhouse Gas (GHG) protocol outlines key methods for reducing Scope 3 emissions, such as implementing sustainable procurement policies, reducing business travel, and enhancing the energy efficiency of assets, particularly tenant spaces.[10]

In late 2023, the Alliance of CEO Climate Leaders, comprising 120 CEOs committed to accelerating net-zero emissions, launched a Scope 3 action plan. Strategies include setting internal Scope 3 targets, encouraging suppliers to set emissions goals, and engaging partners to promote transparency across the value chain.[11]
The first step in mitigating Scope 3 emissions is to understand your organization's Scope 3 impact. This effort requires collaborative engagement with suppliers and partners to make the greatest impact.



The Westory Rooftop Terrace

[10] Scope 3 Detailed FAQ.pdf (ghgprotocol.org)

[11] Scope 3 Action Plan - Alliance of CEO Climate Leaders (weforum.org)

MEGATREND **5**

PARTNERING WITH TENANTS ON ESG THROUGH GREEN LEASING

Partnering with Tenants on ESG through Green Leasing

Green leasing practices are becoming increasingly prevalent as landlords and tenants recognize the importance of collaborating on ESG initiatives. Green leasing involves incorporating lease language that aligns landlord and tenant interests around sustainability initiatives, such as energy efficiency, water conservation, and other environmentally preferred measures in construction and operations.

An analysis of energy efficiency measures facilitated by executed green leases found the potential to reduce the energy consumption of U.S. office buildings by 22% and yield reductions in utility costs of up to $0.51 per square foot.[12]

Through these mutually beneficial partnerships, green leasing aims to promote environmental sustainability, increase transparency, and produce cost savings.

[12] Measuring the Potential Impact of Green Leases in the U.S. Office Sector - IMT

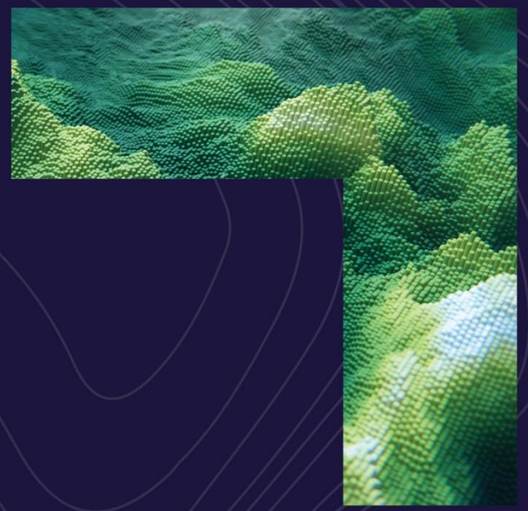
To set the standards for green leasing practices, the U.S Department of Energy's Better Buildings Alliance and the Institute for Market Transformation created the Green Lease Leaders program (GLL).

GLL advances green leasing initiatives with established guidelines and recognition of excellence across three levels of achievement.

This year's GLL awardees cover almost 2.9 billion square feet, and the number of platinum-level winners—the highest tier of recognition—has increased by over 100% since last year.[13]

The growth of this program reflects the industry recognition of benefits green leasing offers for complying with regulatory requirements, achieving ESG goals, and fostering industry collaboration.

[13] Department of Energy and IMT Announce 2024 Green Lease Leaders Awards - IMT



MEGATREND **6**

DIGITAL TRANSFORMATION

Digital Transformation

Innovative property technologies and AI-powered systems are revolutionizing property management and building performance optimization. The global smart building market size is projected to grow to $568 billion by 2032.[14] Measuring and managing building performance is more efficient than ever with technological advancements.

Technological advancements can facilitate improved decision making based on data for more successful ESG programs and operations. According to the World Economic Forum, properties utilizing system automation technologies are 120% more likely to accurately measure emissions and 90% more likely to reduce emissions in line with their ambitions.[15]

[14] Smart Building Market Size, Share & Growth Report [2032] (fortunebusinessinsights.com)
[15] https://www.bcg.com/publications/2022/using-technology-helps-companies-measure-and-reduce-emissions

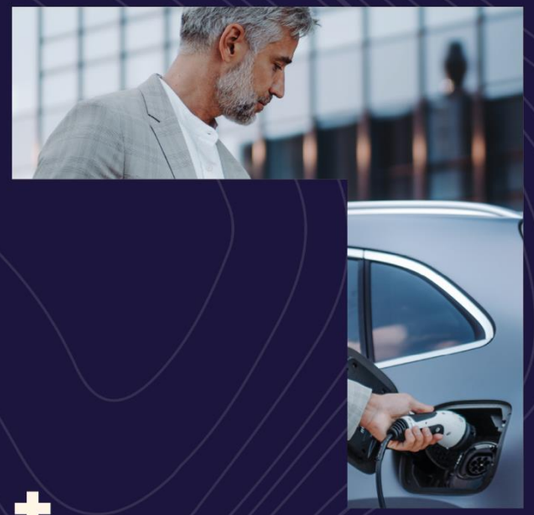
For example, installing a building management system (BMS) with direct digital control to manage HVAC systems and building equipment schedules can lead to energy savings of up to 29% and an additional 9% if including add-ons such as fault detection and diagnostics.[16]

Successful implementation of proptech solutions not only results in energy efficiency and cost reductions, but also enhances tenant experience. AI-powered building management systems can optimize building performance to provide the ideal balance for maximizing tenant comfort while minimizing energy costs in a building.[17]

The use of AI through the sustainability lens in property management is anticipated to empower decision making, optimize efficiency, and enhance the tenant experience.

According to the World Economic Forum, properties utilizing system automation technologies are 120% more likely to accurately measure emissions and 90% more likely to reduce emissions in line with their ambitions.

[16] Expert: Building management system can cut emissions, boost sustainability (interestingengineering.com)
[17] Proptech for CRE tenant experience in office buildings (buildingengines.com)



MEGATREND 7

ASSESSING + MITIGATING CLIMATE RISK

Assessing and Mitigating Climate Risk

Climate change poses significant risks to the long-term viability of real estate assets, so understanding the short-, medium-, and long-term climate-related physical and transition risks is crucial for informed decision-making. By identifying and mitigating climate-related risks, portfolio owners can understand the associated costs and capitalize on emerging opportunities.

The impacts of climate change—increased flood risk, wildfires, heat stress, and drought—can profoundly affect surrounding communities, physical environments, and property values. In 2022, the National Oceanic Atmospheric Administration reported an inflation-adjusted $165 billion in damages from climate and weather catastrophes. Tracking only those extreme weather events that caused at least $1 billion in damages, this made 2022 the third highest cost of extreme weather damages since 1980.[18]

[18] 2022 U.S. billion-dollar weather and climate disasters in historical context | NOAA Climate.gov

In addition to the physical impacts, this heightened level of risk is having vast financial implications for commercial properties. While property insurance expenses typically increase by 2-3 percent per year, year-over-year (YOY) increases have spiked to over 17% in some markets and have seen a 7.6% annual growth rate for CRE properties nationally since 2017—with higher impacts on properties most exposed to acute climate risk. In areas of California with moderate to very high fire risk, there has been a YOY increase in insurance non-renewals due to soaring prices and refusals of coverage.[19]

By leveraging climate risk assessments, one can evaluate the risks associated with existing assets and across a portfolio, considering both physical and transition risks to identify improvement opportunities. Incorporating climate resilience into your portfolio's investment strategy is crucial to safeguarding your investments in the face of these physical and transition risks over the long term.

[19] https://www.insurancejournal.com/news/west/2020/12/04/592788.htm

Conclusion

Navigating the evolving landscape of sustainable real estate requires keeping up with the latest megatrends. As sustainability partners, Cushman & Wakefield offers support in staying up to date with reporting practices, understanding portfolio expectations, and implementing cutting-edge solutions. Whether it's complying with regulations, fostering ESG partnerships, harnessing proptech and AI, or mitigating climate risks, we are committed to empowering portfolio owners to thrive in a sustainable future.

It all starts with data—the better a company measures its emissions, the more it can reduce them.[20] Prioritizing data completeness and quality by utilizing technology and tenant partnerships can lay the groundwork for effective sustainability initiatives, ensuring regulatory compliance and strengthening the long-term viability of assets in the face of climate change.

[20] GAMMA-AI-Emissions-Slideshow-03 (bcg.com)

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