ESG - the hot topic for the real estate industry in 2021

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There is nothing like a pandemic to focus people's minds on what really matters. It is therefore maybe not surprising that Environmental, Social and Corporate Governance (ESG) factors are moving up the agenda and becoming increasingly important to investors, lenders and businesses.

ESG are three key criteria used in determining the sustainability and societal impact of a business. These criteria are becoming a priority for all in the real estate industry. As we begin to emerge from the COVID 19 pandemic, health, wellbeing and social impact are at the top of our agendas and we expect to see this concern translated into our built environment over the coming years. The increasing importance of ESG is a reflection of how society and its attitudes are changing. The challenge is to adapt, or risk being left behind.

Property developers have been at the forefront of the green debate for the past decade with the pressure to deliver more sustainable developments, using renewable materials and which are energy efficient. However now, with a renewed emphasis on climate change and what is being dubbed the 'Greta Thunberg Effect' there is a noticeable shift to really drive change across the industry.

One of the issues facing the industry has been 'greenwashing' where companies or investment products overstate their green credentials. Both national and international initiatives are seeking to address this by introducing frameworks and greater disclosure and transparency. The Loan Market Association (in consultation with representatives from leading financial institutions active in the global syndicated loan markets), have published the Green Loan Principles, a framework for green loans and the Sustainability Linked Loan Principles, a framework for sustainability linked loans, with a view to promoting the development and integrity of green and sustainable loan products. It is hoped that the widespread adoption of these will mitigate the risk of greenwashing.

In addition, this month marks the entry into force of certain obligations under the 'Sustainable Finance Disclosure Regulations' (SFDR) across the EU. These regulations, implemented by the European Commission, form part of a framework of legislation aimed at increasing genuinely sustainable investment and avoiding this issue of 'greenwashing' investments. The regulations aim to increase transparency around green investment, by imposing obligations on companies who produce financial investment products, to make certain disclosures on their websites.

These disclosures must contain certain information about the company's internal governance and how sustainability is incorporated into decision making as a company. They also require disclosures to be made at the product level, such as in prospectuses, regarding how exactly products achieve sustainability goals. Although technically, post Brexit, the SFDR does not form part of retained EU law and therefore does not apply in the UK, in practice, many UK businesses, financial products and fund managers will need to comply with the rules to be able to access the European market. These measures will therefore continue to be very relevant.

The staggered introduction of these regulations since they were published in 2019 has already shone a spotlight on sustainability and we are seeing this permeate through the real estate industry, with the majority of new developments having sustainability at their core. The financing of such green developments has also undergone a green transformation over the past few years with lenders typically offering borrowers a lower margin, and therefore lower borrowing costs, if certain pre-agreed sustainability performance indicators are met or if the proceeds are used for a green purpose, such as a development that meets nationally recognised green standards. Some of the leading bank lenders have announced specific funds and initiatives (including for example Lloyds Bank Group's £2 billion 'Clean Growth Finance' package and HSBC's commitment to provide $100 billion in sustainable financing and investment by 2025) and non-bank lenders are also increasingly focused on ESG requirements as part of their real estate lending strategy.

Over the past few years, tenants and investors have also been pushing real estate mangers to make their properties more environmentally sustainable. Big tenants are now hiring heads of sustainability so their sophistication is rising, as are their demands. We are seeing landlords and tenants work collaboratively to make upgrades and have seen many green initiatives coming through from our clients with many opting to include 'green clauses' into their leases. These clauses are an example of directly incorporating sustainability into building usage. These green clauses see landlords and tenants sign up to green obligations under their leases such as energy efficiency measures, reduction in /sustainable management of water usage and green waste management policies. As the government progress with their climate change targets, we expect to see sustainability play a larger role in the considerations of our clients' projects.

ESG can genuinely be a win win for all parties. While change only happens if there is demand for it, now more than ever there seems to be a strong desire across the industry to make a real difference.