



## ESG real estate insights

### Global perspectives on sustainability and climate

#### Real estate sustainability due diligence

It is hard to imagine financial due diligence without well-defined financial accounting standards. With sustainability performance on the minds of investors and those that seek to attract them, the corollary is apropos; well-defined sustainability standards and frameworks are accelerating the path to a more efficient real estate investment market. Real estate market participants may have much to gain in learning the new “grammar” of Environmental, Social, and Governance (ESG) and incorporating it into their diligence programs.

Sustainability accounting standard setters are issuing new and converging standards and frameworks that can be used to assess sustainability performance. These new standards will likely increase the ability for both parties in a real estate transaction to communicate in a similar language. This maturation means that investors looking to better understand an investment’s sustainability performance, opportunity, and risk will be able to request information in alignment with its standard and framework of choice.

The rapid acceleration in the issuance of new and the convergence of existing ESG standards and frameworks has occurred against a backdrop of societal change, increased environmental regulation and risk, and reimagining of how real estate users live and work. These trends make the need for consistent, comparable metrics on which to communicate risk and opportunity more critical.

For managers seeking to raise capital, being able to furnish information on ESG factors in alignment with standards and frameworks may allow them to communicate that the information provided in diligence meets the boundaries, assumptions, and judgments expected from an investor. While judgments in accounting for ESG performance will persist, a mature standards and frameworks landscape should lead to greater transparency among negotiating parties. Those able to furnish this ESG information will likely have a competitive advantage and thus a greater access to capital.

Here are a few examples of standards and frameworks and how they might provide a common language between negotiating parties.

#### Task Force on Climate-related Financial Disclosures (TCFD) and evaluating climate resiliency

The TCFD was founded in 2015 by the Financial Stability Board. The TCFD framework provides organizations the recommended language to describe, among other matters, physical and transition risks from climate change. Disclosures prepared in accordance with this framework could, for example, assist a real estate fund in assessing its properties' climate resiliency to physical risks such as extreme weather events. The TCFD provides objective measures, a common language, by which a preparer can measure and disclose this risk, information which may be useful in diligence.

#### Greenhouse Gas Protocol (GHG Protocol) and assessing the risk of carbon emissions limits

The GHG Protocol was developed by the World Resources Institute and World Business Council for Sustainable Development in 1998 and is the most widely-respected accounting standard on measuring and managing carbon emissions.<sup>1</sup> The GHG Protocol is undergoing a modernization effort and is expected to be updated in 2023.<sup>2</sup> However, it remains in use today and is of particular importance to real

estate, as jurisdictions globally have mandated reduction requirements on carbon emissions. In some jurisdictions, if those reductions are not met, real estate owners may be levied significant fines and penalties. For those involved in legal and regulatory due diligence on real estate investments, understanding the current state of carbon emissions through the common language of the GHG Protocol will likely be critical to being able to assess the future cash flow uncertainty from those investments.<sup>3</sup>

### Speaking a common language

The “grammar” (i.e., standards and frameworks) on sustainability will likely continue to evolve in an effort to meet the needs of investors. Leaders should consider engaging in a dialogue with those from which they seek to obtain ESG information or those to which they wish to provide ESG information. They should also identify which risks and opportunities are deemed most relevant and leading standards and frameworks that give the most appropriate “grammar” to address those risks and opportunities. If both parties in diligence can have a mutual understanding on what standards and frameworks will be leveraged in information provided, the diligence process will likely be smoother and the assumptions underlying valuation, will likely be better known.

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1. Gendre, “What is the Greenhouse Gas Protocol,” Greenly, Jan 22, 2023.
2. Greenhouse Gas Protocol, “Survey on Need for GHG Protocol Corporate Standards and Guidance Updates,” Accessed May 3, 2023.
3. Deloitte, “Deloitte response to the survey on the need for GHG protocol corporate standards and guidance updates,” March 23, 2023.



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