Family Office Insights

ESG Investments: US Green Build Voluntary Certification Programs and Regulatory Framework

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As sustainable investing continues to grow in popularity, family offices have taken note. Investor surveys indicate that more and more respondents take the non-financial performance of a company into consideration in their investments, which include environmental, social and governance (ESG) strategies.

Of the most important ESG criteria to investors, green building certification ranked as the top.[1] In addition to the voluntary green certifications available to companies, a number of regulatory entities have enacted or are in the process of enacting green build requirements. Here, we examine the background and future of green certifications and green build requirements, along with how such certifications and other ESG criteria can be factored into real estate investments.

US Regulatory Framework

Green certifications can serve to signify a building's environmental friendliness and stewardship. In the 1990s, the Building Research Establishment's Environmental Assessment Method (BREEAM®) rating system was established, which utilizes third-party certification to assess an asset's ESG performance.[2] This system was established in the UK but is recognized internationally for its ability to assess the environmental performance of both new and existing properties. With respect to green building within the US, the US Green Building Council (USGBC) was established in 1993. By the late 1990s, USGBC had established its first version of a green building rating system for green building design, construction, and operation, which is known as Leadership in Energy and Environmental Design (LEED®).[3] The last few decades have seen an increase in green building certification popularity.

Over time, hundreds of different green certifications have been established; however, it is important to choose a legitimate, widely accepted and tailored green certification. Facilities seeking green certification should generally consider programs that are third-party certified, which means that an independent party with no interest or financial ties to the project has made the determination. Furthermore, green certification programs that are most widely accepted include some type of ongoing verification of certification compliance. For example, LEED recertification allows a project previously certified under LEED to submit 12 months of data and receive recertification valid for three years.

By encouraging recertification, these programs ensure that real estate continues to demonstrate environmental and energy sustainability over time. Notably, a decision on which green certification(s) to seek may largely be driven by which types of certifications investors deem important.

One reason that the role of certification is often undertaken by third-party programs is that no centralized governmental agency in the US is tasked with determining green certification. Some states have established their own recognition programs for implementation of environmentally friendly and pollution-reducing activities. For example, the Ohio Environmental Protection Agency (Ohio EPA) has established its "Encouraging Environmental Excellence (E3) Program," which recognizes Ohio businesses for their environmental stewardship.[4] Under this program, businesses submit an application providing information on a number of criteria, including sustainable materials and purchasing, pollution prevention, energy efficiency, green building and renewable energy.

Outside of these voluntary green certification programs, several states have established or are in the process of establishing green building requirements. For example, California passed Senate Bill 32, which requires statewide greenhouse gas (GHG) emissions to reach a level 40% below 1990 levels by 2030.[5] California legislators and regulators believe that an important component of lowering GHG emissions is through building decarbonization. As a result, the California Air Resources Board (CARB) is focusing on advancing "zero emission buildings," which includes statewide strategies for building standards codes, as well as encouraging a voluntary effort to go beyond mandatory code requirements. Similarly, the New York City Council passed legislation, known as the Climate Mobilization Act, to reduce GHGs and improve energy efficiency for New York City buildings.[6] In part, the legislation establishes emissions caps for buildings over 25,000 square feet and roofs of smaller, new residential and non-residential buildings will be equipped with a solar photovoltaic system or a green roof.

1 https://www.wealthmanagement.com/investment-strategies/10-takeaways-afire-s-2021-international-investor-survey

2 BREEAM® is a registered trademark of BRE (the Building Research Establishment Ltd. Community Trade Mark E5778551). The BREEAM marks, logos and symbols are the copyright of BRE and are reproduced by permission.

3 LEED® is a registered trademark. Further information can be found at www.usgbc.org

4 https://www.epa.state.oh.us/ocapp/ohioe3

5 https://ww2.arb.ca.gov/our-work/programs/building-decarbonization/about

6 https://council.nyc.gov/data/green/

Considerations for Owners of Real Estate

Owners of real estate assets can incorporate ESG in a property's design and operation by obtaining green certifications. Not only can such certifications reduce maintenance costs for owners, but certifications also attract certain prospective tenants and buyers who want to factor ESG into their investments. In addition to certifications, ESG criteria can be tracked during the period of ownership of property by the selection of third-party property managers who will monitor the property in accordance with such criteria, whether by agreeing to minimum monitoring standards or via incentive fees to reward meeting set ESG targets.

In addition to demonstrating that a property is well managed, identifying and tracking ESG during the period of ownership limits unforeseen risk at the time of disposition of the property that could affect purchase prices.

In addition, real estate owners can incorporate ESG concepts into individual tenant lease agreements in various ways. For instance, owners can require that tenants cooperate with the owner/landlord in obtaining and maintaining compliance with the owner's green certifications, and, increasingly, laws regarding carbon neutrality for buildings. The owner/landlord may require that tenants participate in a recycling program, or have each tenants' utilities sub-metered to monitor usage. Leases may even contain use restrictions that range from prohibiting gas stations in retail shopping center developments to requiring office tenants to use only "clean" dry-cleaning services. Incorporating ESG into leases can be a win-win to both landlords and tenants, as landlords can pass through capital expenditure costs on ESG projects or green certifications to tenants, while tenants can receive the benefit of the cost-savings on their utility or operating expense payments.

Increased state and local programs encouraging and/or requiring green building requirements indicate the growing importance of green building to owners of real estate assets. As real estate owners, buyers and tenants continue to consider a building's environmental stewardship and sustainability efforts, green certification, in addition to other ESG criteria, will be at the forefront of investment decisions.

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