

Real Estate Lending and Sustainability: The Case for Better Risk Management

With thanks to



#sustainablelending

5th November 2015

THE UK'S LEADING COMMERCIAL PROPERTY OWNERS
WORKING TOGETHER TO IMPROVE THE SUSTAINABILITY OF
EXISTING COMMERCIAL BUILDING STOCK



The BBP is

A collaboration of the UK's leading property owners who work together to improve the sustainability of the UK's existing commercial buildings.

Our aim is to

Enable market transformation through sustainability leadership and knowledge sharing across the property industry.

Members

Aberdeen

AVIVA
INVESTORS

Blackstone

British
Land

bruntwood

CADOGAN

CANARY WHARF
GROUP PLC

Capital &
Regional

CLS Holdings plc

CORDING
REAL ESTATE GROUP

Deutsche Asset
& Wealth Management

GROSVENOR

Hammerson

HERMES
INVESTMENT MANAGEMENT

intu

LandSecurities

LaSalle
INVESTMENT MANAGEMENT®

Legal &
General
Investment
Management

M&G
REAL ESTATE

QUINTAIN

SEGRO
WHERE BUSINESS WORKS

Shaftesbury

TH Real Estate

THE CROWN
ESTATE

26

Members

+£180bn

Assets Under Management

450m

sq ft

Our Objectives

Share
Knowledge

Demonstrate
Leadership

Promote
Innovation

Influence the
sector

Support
Collaboration

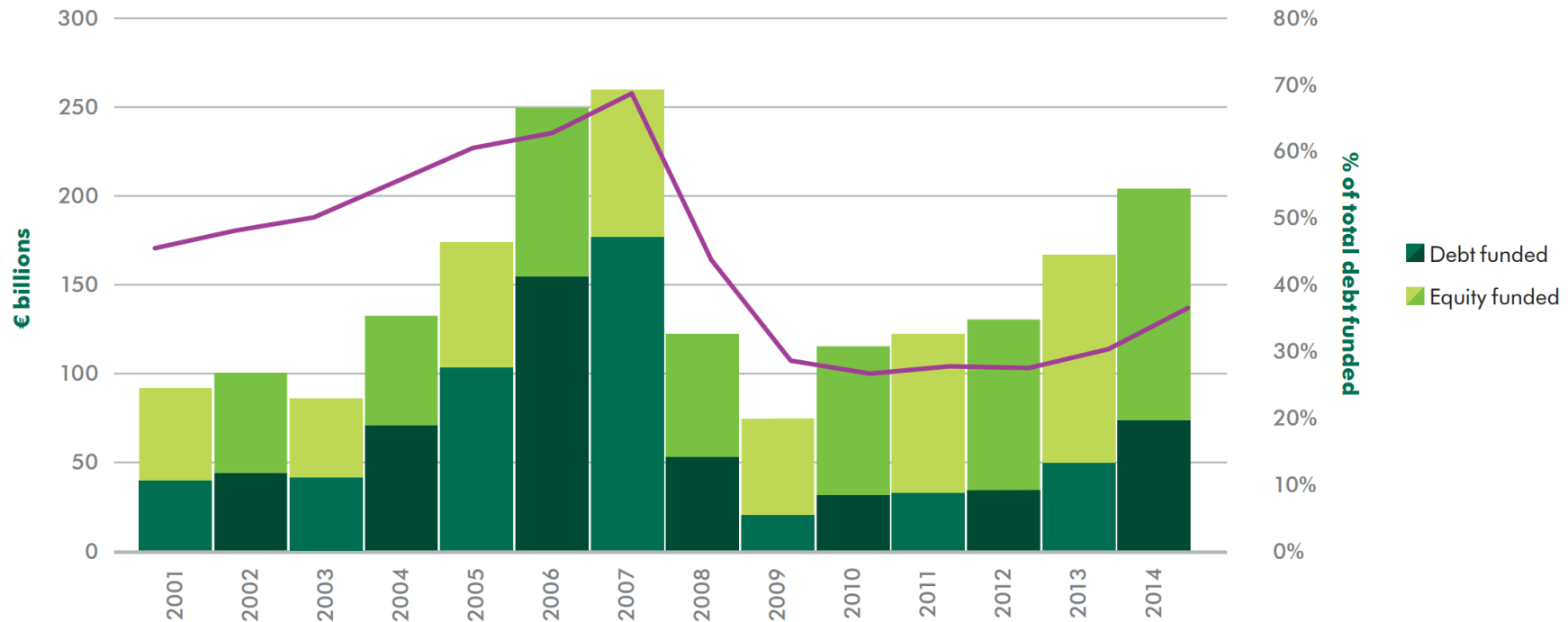
Our Priorities



Real Estate Debt Market

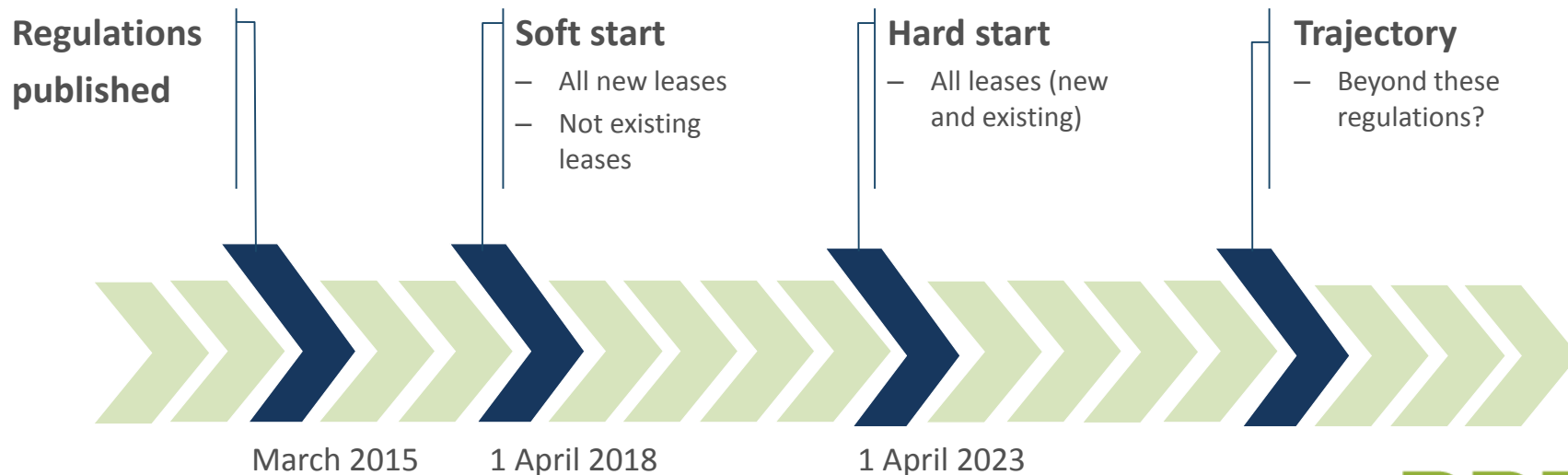
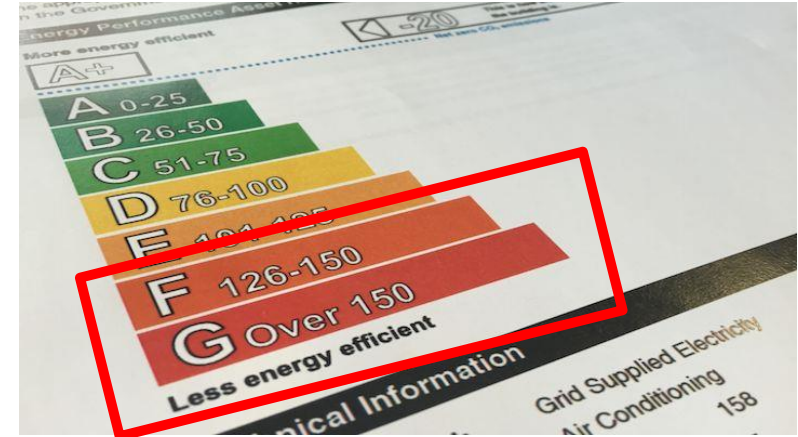
Total volume of European CRE debt actually increased by €23 billion over the course of 2014

TOTAL EUROPEAN CRE INVESTMENT TURNOVER
2001 to 2014



Minimum Energy Efficiency Standards

Unlawful in England & Wales to let residential or business premises that do not meet EPC rating of 'E' or above



CRE Lending Working Group



Deutsche Asset
& Wealth Management



Loan
Market
Association
The authoritative voice
of the European Market



TH Real Estate

Why is sustainability relevant?

- ❑ Risk management:
 - Incorporate sustainability considerations into due diligence, underwriting, deal structuring and loan documentation
 - Better ongoing monitoring of existing loan portfolio
- ❑ Future-proofing regarding regulation and regulators!
- ❑ Interest from SRI investment community?
- ❑ Improved borrower relationship
- ❑ Opportunities for new products & business models

MEES Risks....

Ability for borrower
to pay back loan?

Additional capital
expenditure?

Negative impact on
collateral value?

Increased void
rates?

Increased loan to
value ratio?



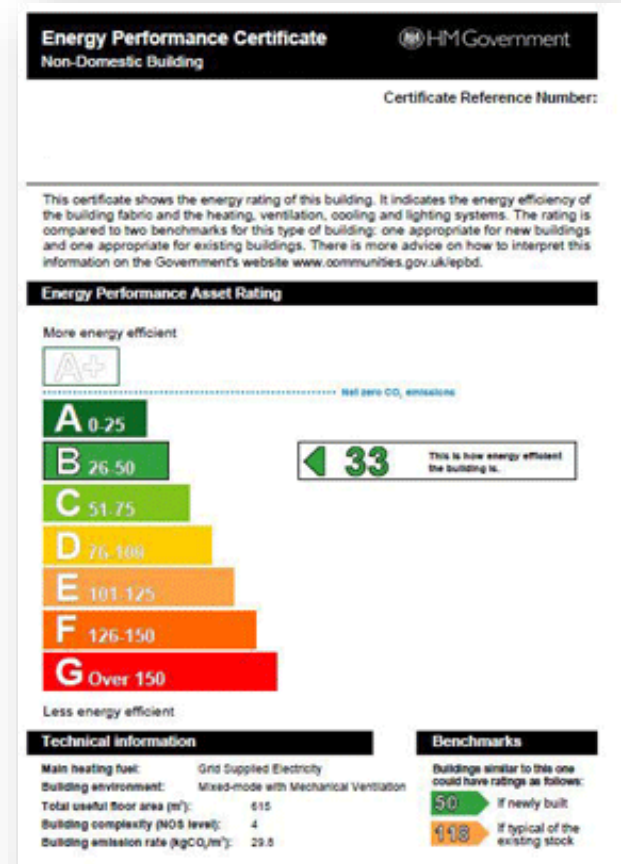
Mitigation strategy – New lending decisions

✓ REVIEW EPCS AS PART OF DUE DILIGENCE

✓ ASSESS & UNDERWRITE RISK

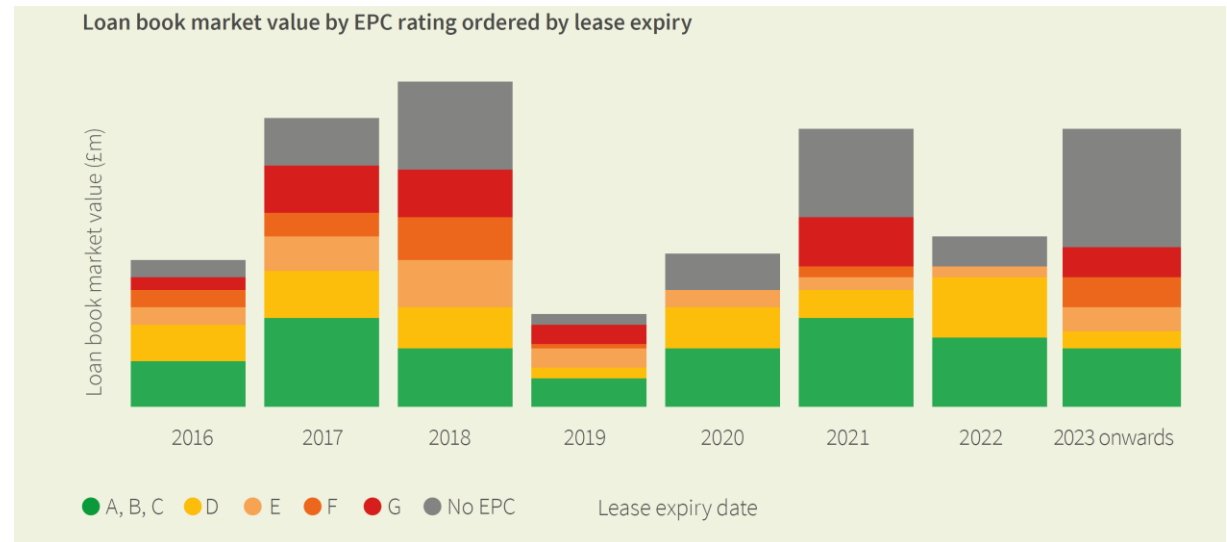
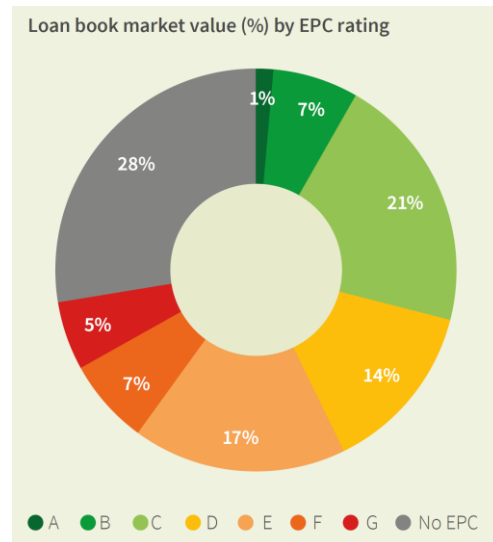
✓ CONSIDER STRUCTURING & LOAN DOCUMENTATION

- LMA real estate finance template facility agreement



Mitigation strategy - Existing loan book

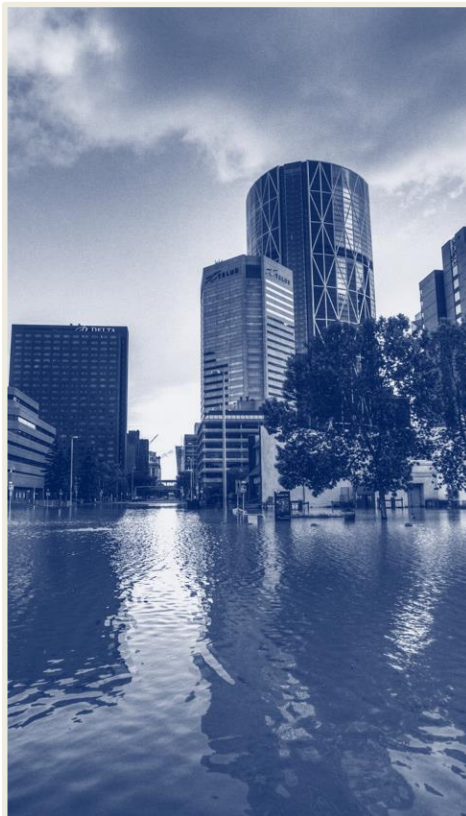
- ✓ START COLLECTING & MONITORING EPC DATA
- ✓ INCORPORATE DATA INTO EXISTING MONITORING



- ✓ REVIEW LOAN DOCUMENTATION
- ✓ ESTABLISH A PROACTIVE BORROWER ENGAGEMENT STRATEGY

Wider sustainability considerations

FLOODING



RATINGS

BREEAM®



BORROWER CREDENTIALS

 **PRI** | Principles for Responsible Investment



Beyond risk management...



BBP Industry Insight



Keeping in touch with the BBP





G R E S B[®]
REAL ESTATE DEBT

2015 RESULTS RELEASE

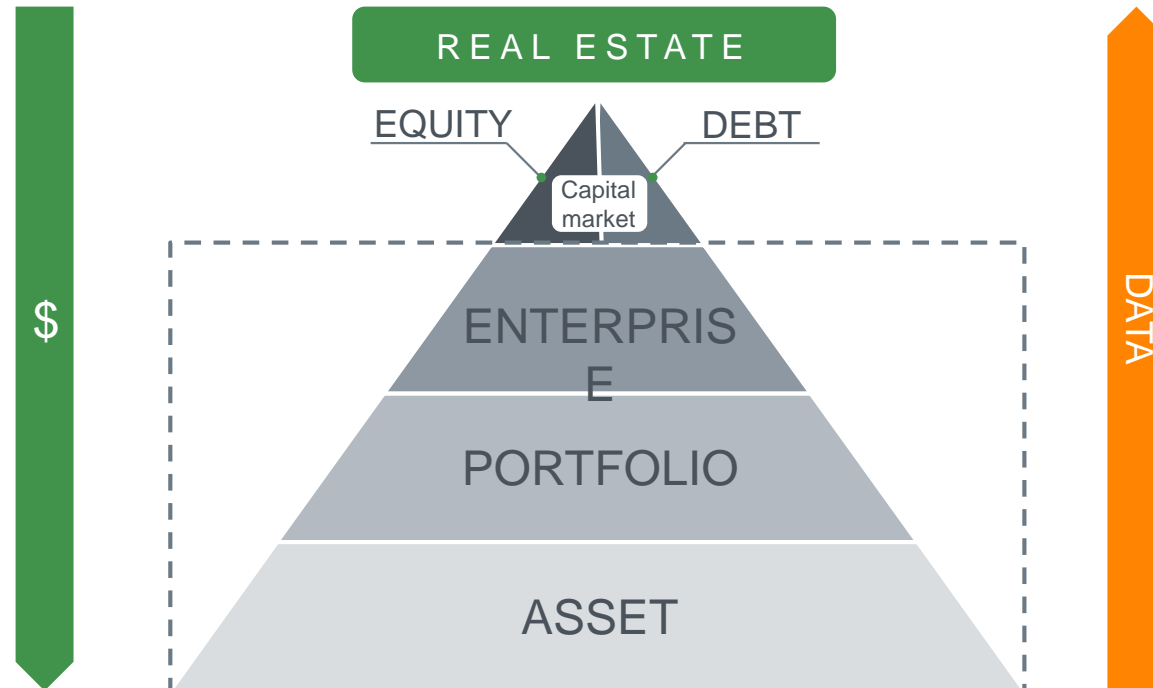
How is sustainability related to credit risk...?

- No upside, but...
- Better performing property = better credit risk?
- 20-30% lower default rates associated with Energy Star and LEED certified buildings (An and Pivo, 2015)

Financial benefits

- Higher rental levels
- Lower vacancy levels
- Lower operating costs
- Higher capital values
- Increased asset liquidity

...and the capital market?



About GRESB

Actionable transparency for institutional investors

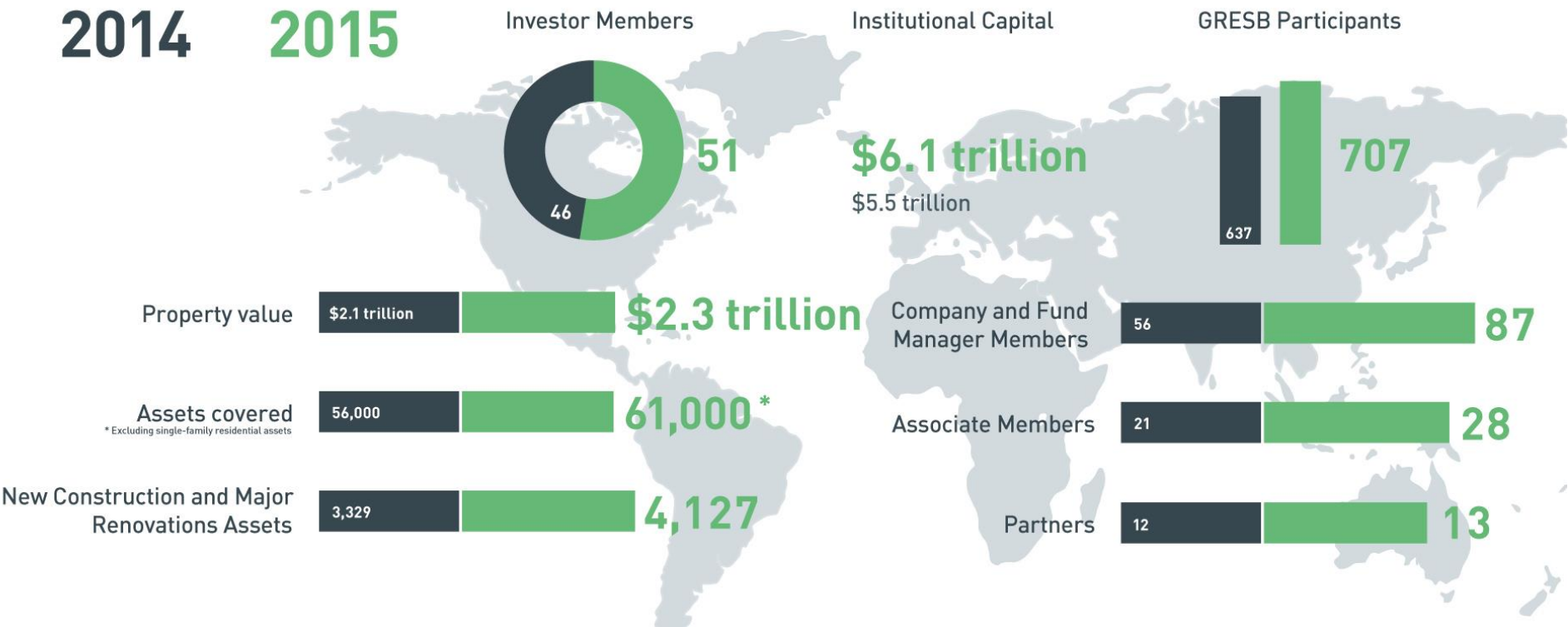
- A platform to **assess** the performance of companies and funds
- A systematic approach to **score** listed companies and private entities
- Global **benchmark** for ESG performance



“GRESB’s mission is to enhance and protect shareholder value by evaluating and improving sustainability best practices in the global real asset sector.”

GRESB Real Estate

In numbers



GRESB Debt

Actionable transparency for institutional investors

- Applying the same mission, vision and process to fixed income property investors
- 2015 Inaugural Debt Survey—
 - Assesses the sustainability performance and engagement of lenders



Aspects and dimensions

6 aspects, all of which look at ESG factors and how they are implemented

Management & Policy



Management



Policy & Disclosure

Implementation & Lender Practice



Risks (bribery & corruption)



Due Diligence



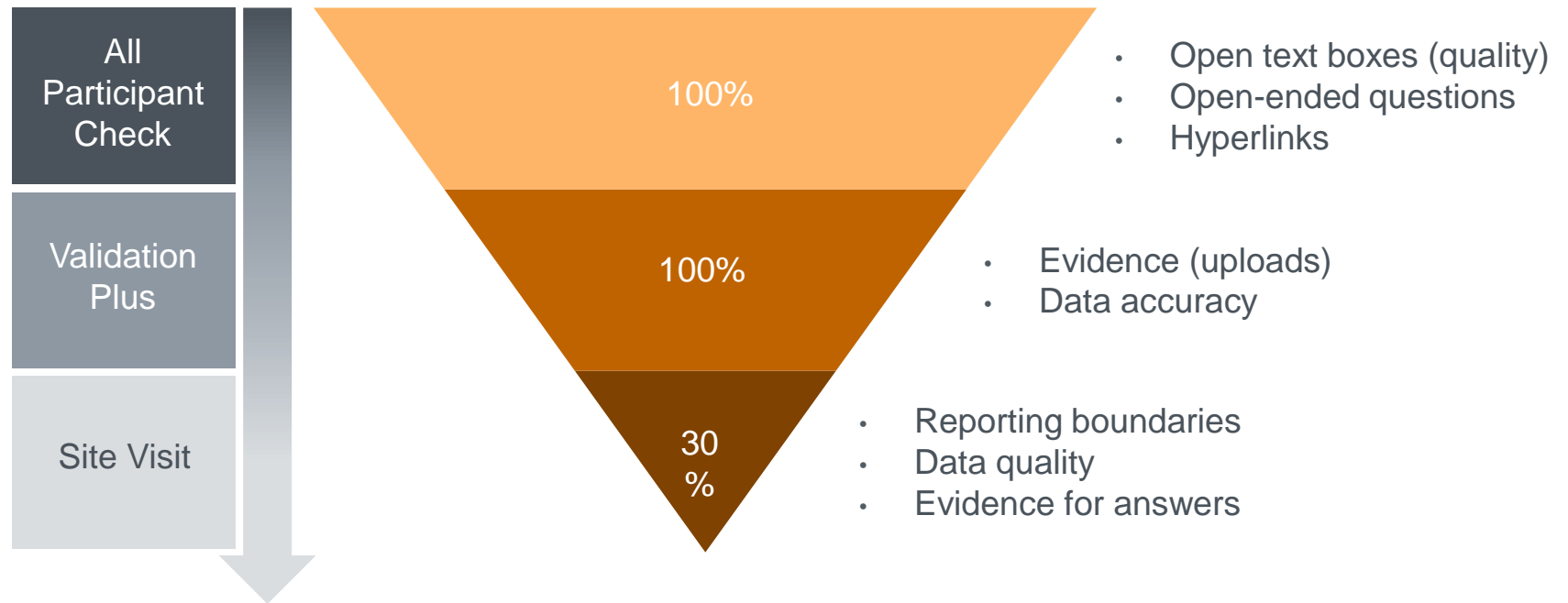
Monitoring



Opportunities

Data validation process

Three-layer procedure to achieve investment-grade data





GRESB Debt

2015 Participation

Participation

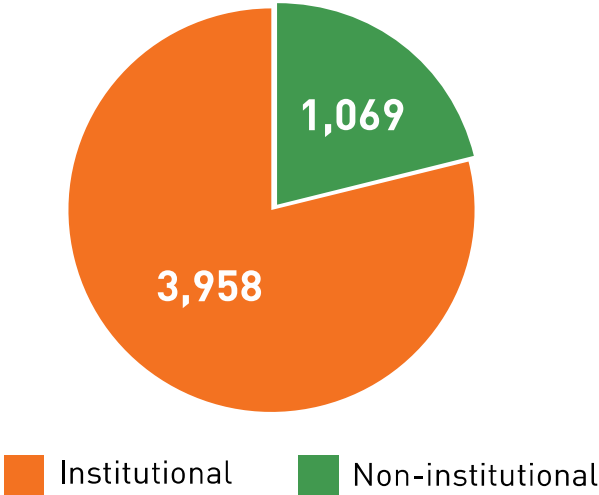
Diverse universe of funds reporting

- 10 funds
- \$5.03 billion in aggregate NAV
- 127 assets (loans)
- Representing 7% of the PERE debt fund universe

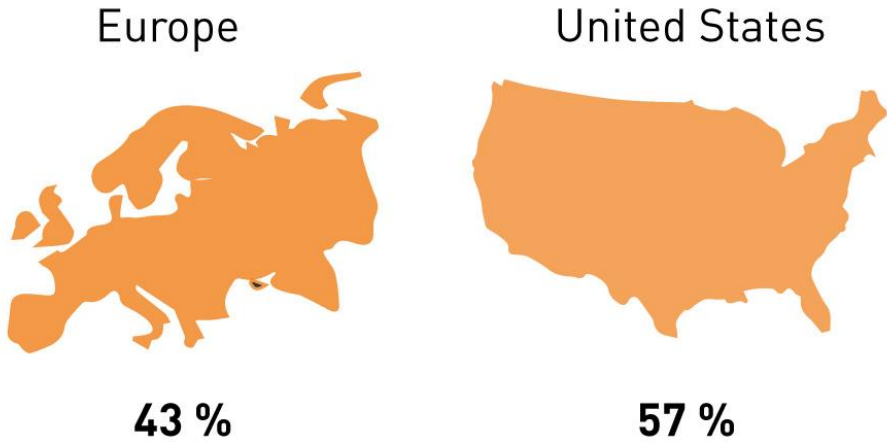
Participation

Based on NAV

Response rate by lender type (based on NAV in USD millions (\$))



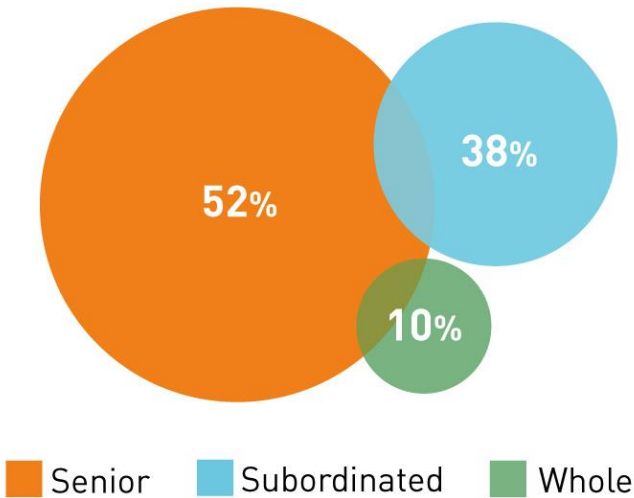
Response rate by geographic focus (based on NAV)



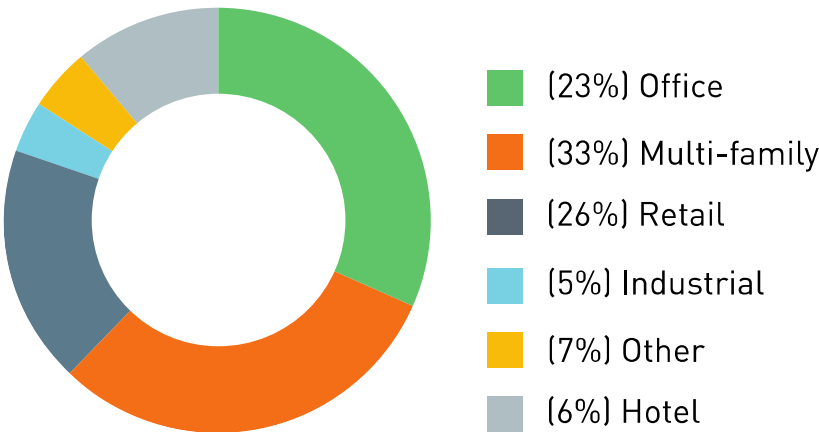
Participation

Based on NAV

Response rate by debt strategy
(based on NAV)



Response rate by property type (based on NAV)



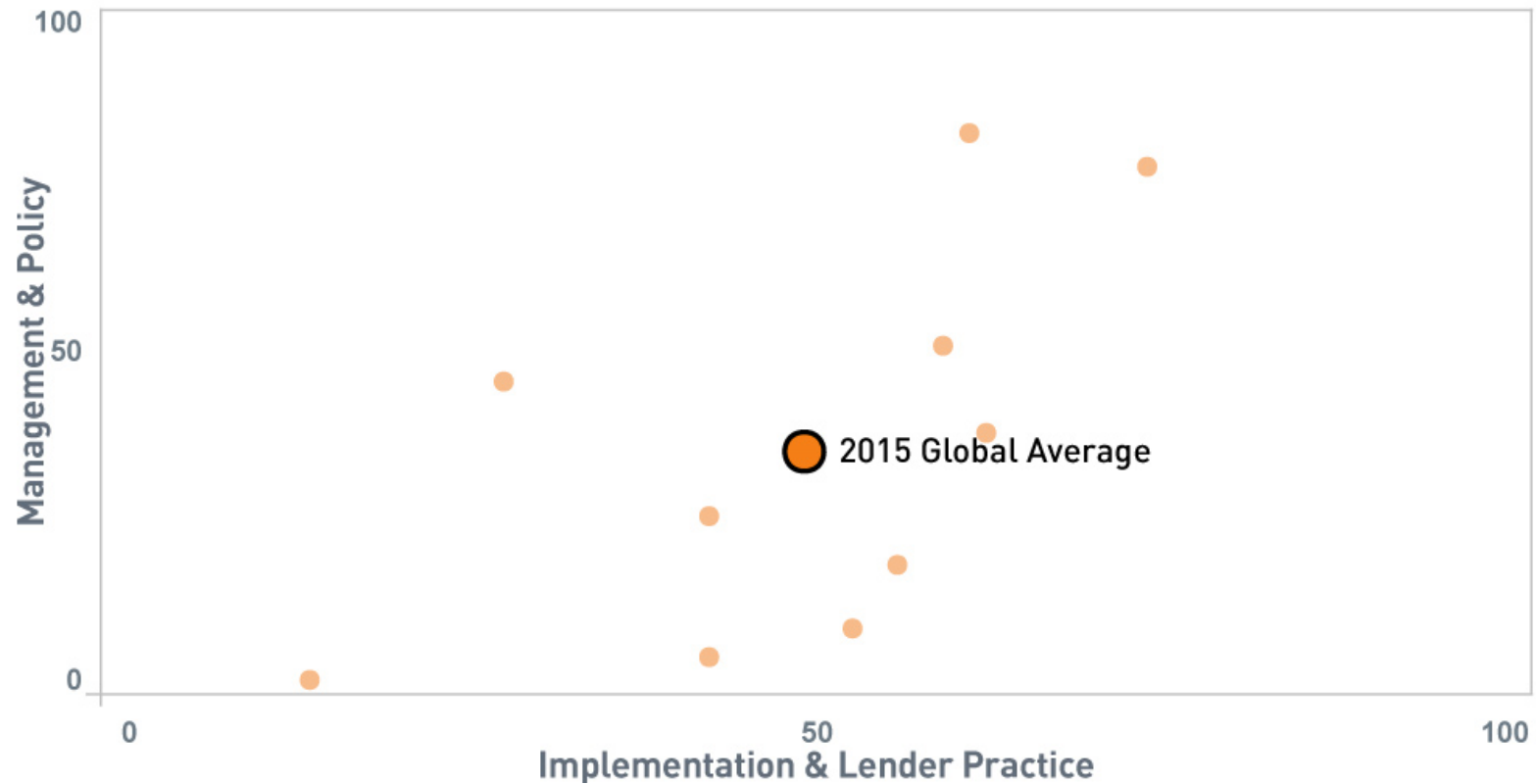


GRESB Debt

Results

Overall scores

GRESB Model reflects absolute and relative performance of Debt funds



ESG scores

Breaking down scores into E, S, and G





GRESB Debt

Main Trends

Main trends



Organizational Integration



Risk Management



Standardization and Capture

Trend 1: Organizational Integration

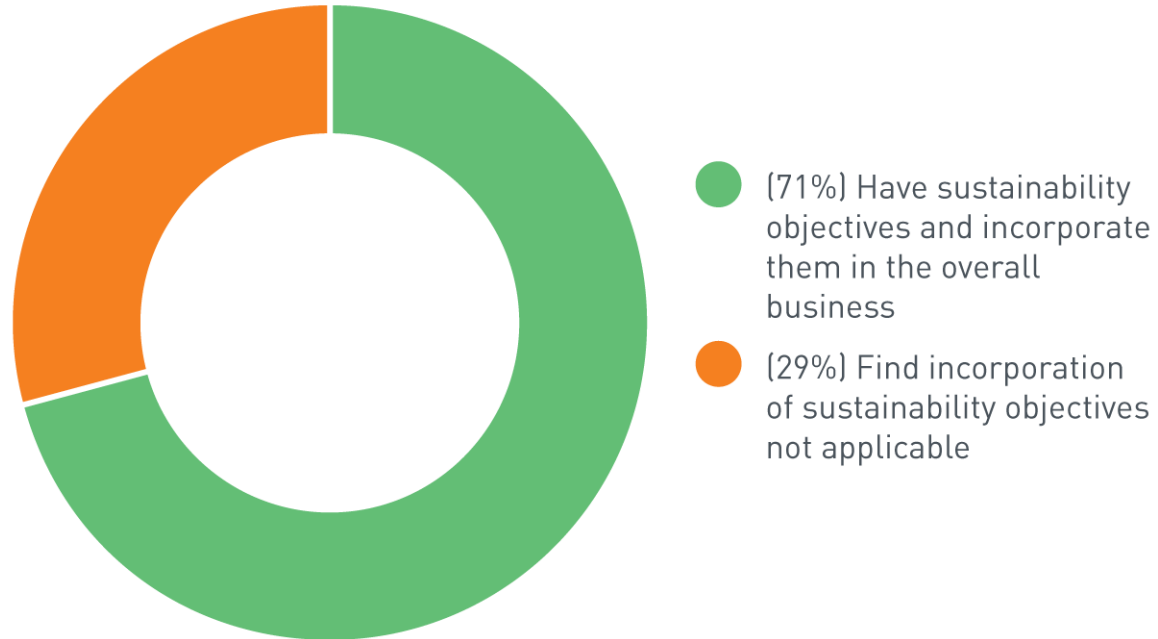
- How well is sustainability integrated throughout an organization?
- Among funds part of a larger investment management organization, are corporate objectives incorporated into real estate lending units?

“By adopting our responsible property investment process, our debt funds seek to apply the same rigorous approach to lending decisions. As part of our investment process, we review the sustainability performance and risks of the underlying properties (environmental audit and building surveys, energy performance certificates, and green building certification such as, BREEAM, LEED, Energy Star, DGMB, and Minergie). The lending committee submission contains a section summarizing the findings.”

David Hirst, Executive Director, Head of Operations, Global Real Estate UK at UBS

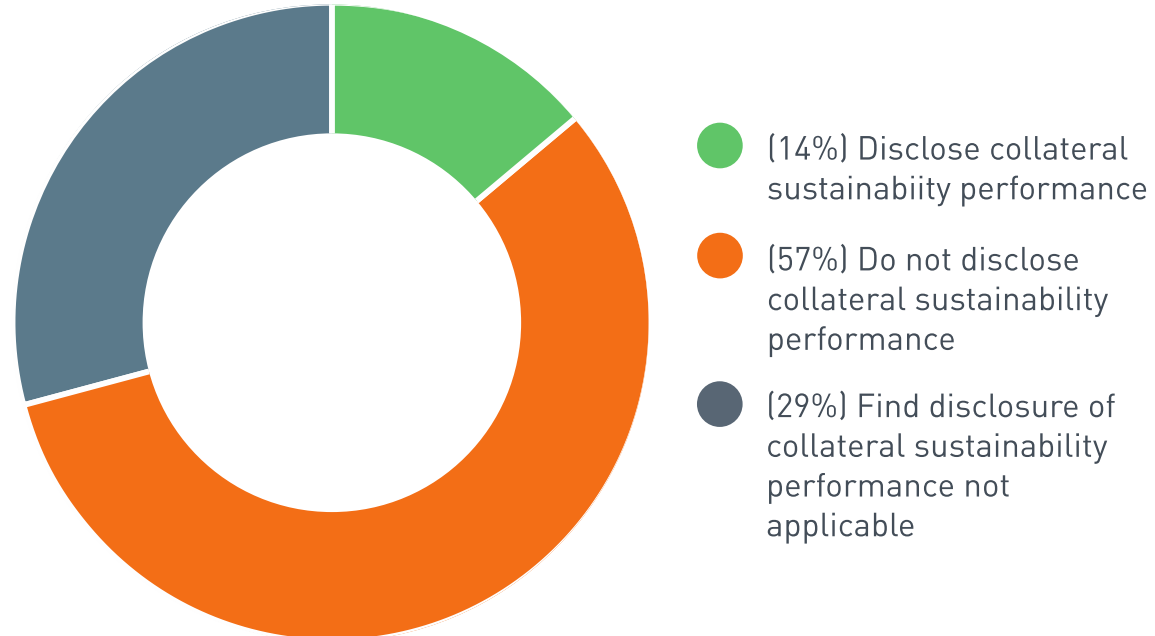
Organizational Integration

Participating funds with one or more persons responsible for implementing sustainability



Organizational Integration

Participating funds with a policy that addresses environmental issues at the collateral level



Wrap-up—Organizational Integration

- Real estate debt funds slower to embrace ESG integration than real estate equity investors
- Sustainability professionals and real estate lenders within the same organization may not be communicating
- Structural shift in organizational communication may be necessary

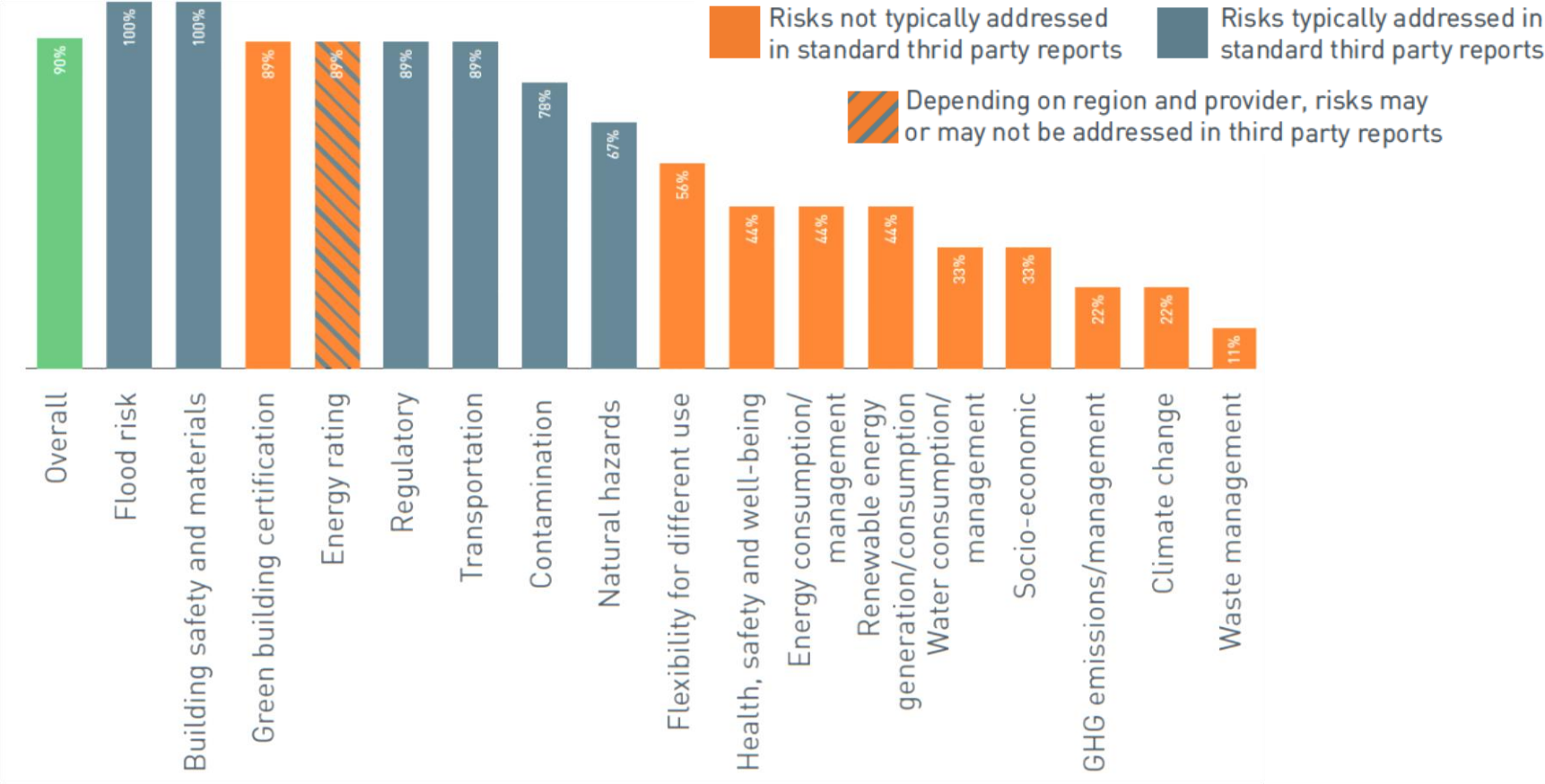
Trend 2: Risk Management

- How aware are lenders about sustainability risks?
- How well are they managing these risks?
- Recent academic research indicates property sustainability features impact loan performance

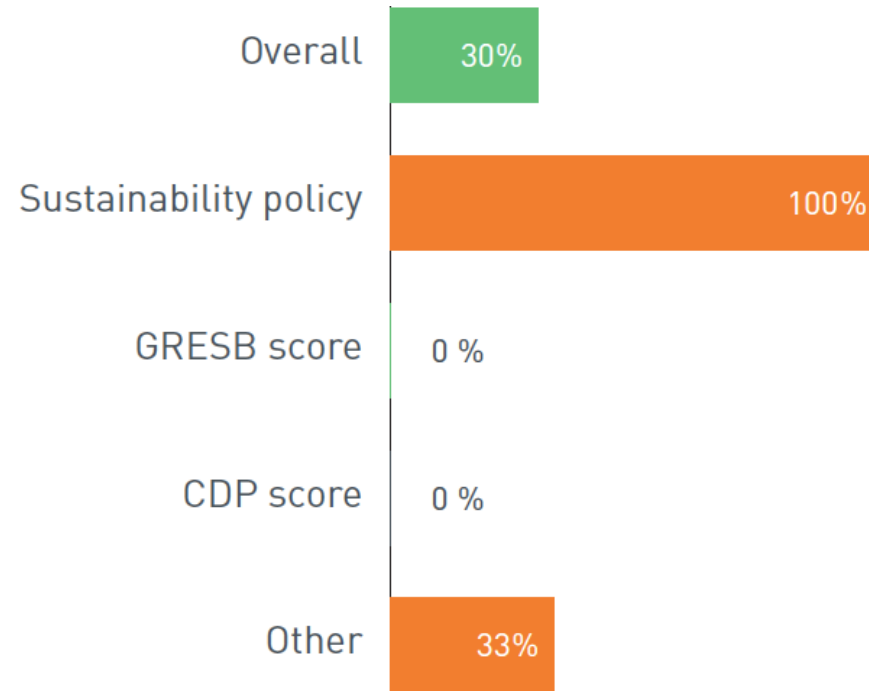
“The sustainability profile of commercial real estate players and properties is becoming increasingly important for banks given the growing number of building regulations, tenants’ expectations in this area and the risks posed by climate change. Our collaboration with GRESB allows ABN AMRO to further integrate sustainability into its real estate financing process, a move closely aligned with the bank’s aim to play an active role in making the real estate sector more sustainable.”

Rutger Schuur, Head of Real Estate & Public Sector Clients at ABN AMRO

Property-level sustainability risks reviewed



Borrower-level sustainability performance review



Wrap-up—Risk Management

- Managing downside risk is critical to delivering consistent risk-adjusted returns
- Requesting and reviewing information pertaining to ESG factors
- During due diligence and throughout the loan term
- To identify risks and become better positioned to mitigate them

Trend 3: Standardization and Capture

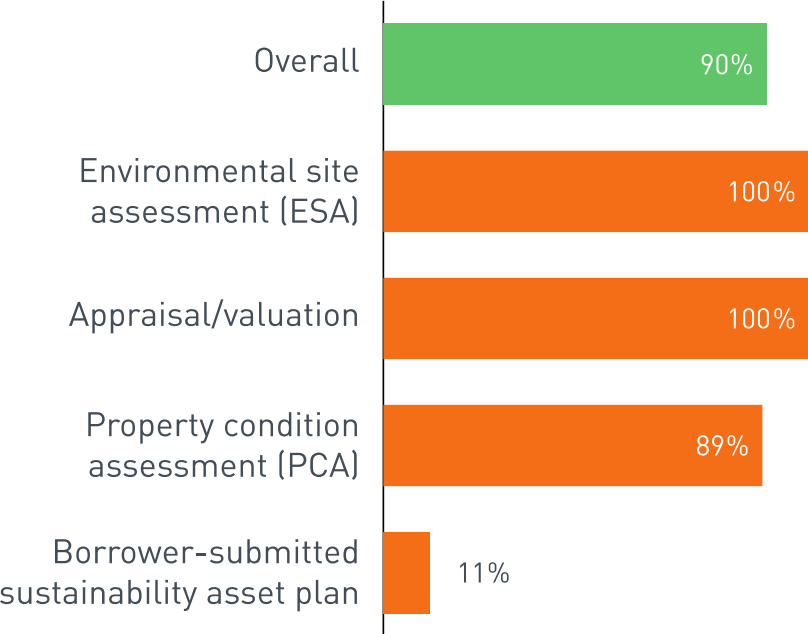
- Loan origination requires degree of customization
- Sustainability risk assessment and management is not standard practice in real estate lending
- When such assessment and labeling sit outside systematic processes and standard practices, corresponding risks and opportunities typically remain uncaptured

“Fannie Mae has integrated sustainability considerations into its underwriting, asset management, and securitization processes. We have done this by leveraging industry-accepted, third party-verified, green building certifications, and by creating our own Green Financing solutions to serve the US Multifamily debt market. By labeling related mortgages and securities, we are able to capture and track the progress and performance of Green MBS.”

Chrissa Pagitsas, Director Green Initiative at Fannie Mae Multifamily.

Capturing risks & opportunities

Standard due diligence items



Wrap-up—Standardization and Capture

- Standardizing borrower-submitted sustainability-based asset plans may allow lenders to better identify sustainability risks and mitigation strategies
- If transaction features that lead to positive environmental or social outcomes are not systematically labeled, they cannot be tracked or reported



GRESB Debt

Conclusion & Next Steps

Innovation in Practice

Real world ESG integration in real estate lending

Innovation in Practice - ABN AMRO

In 2015, ABN AMRO became the first commercial bank in the Netherlands to issue a euro green bond. Proceeds were tied to assets including mortgages on highly energy-efficient homes, loans for solar panels on existing homes and commercial real estate loans for the construction and financing of energy efficient buildings. The Bank utilizes property level sustainability data, such as Energy Performance Certificates (EPCs) and green building ratings to identify these assets within its portfolio.

ABN AMRO has also begun leveraging borrower-level sustainability data in the form of corporate ESG ratings: "The sustainability profile of commercial real estate players and properties is becoming increasingly important for banks given the growing number of building regulations, tenants' expectations in this area and the risks posed by climate change. Our collaboration with GRESB allows ABN AMRO to further integrate sustainability into its real estate financing process, a move closely aligned with the bank's aim to play an active role in making the real estate market more sustainable."

Rutger Schuur, Head of Real Estate & Public Sector Clients at ABN AMRO

Innovation in Practice – Fannie Mae

As of the year end 2014, Fannie Mae has financed \$140 million in Green Preservation Plus loans or loans that are backed by a property with a Green Building certification. These loans are securitized as Green Mortgage Backed Securities (Green MBS), a securitization standard set by Fannie Mae. Fannie Mae collects the ENERGY STAR® Score for Multifamily Housing and Source Energy Use Intensity from properties receiving Fannie Mae Green Financing and from properties that are located in jurisdictions with energy benchmarking reporting laws, such as New York City, Chicago and Washington, DC.

"Fannie Mae has integrated sustainability considerations into its underwriting, asset management, and securitization processes. We have done this by leveraging industry-accepted, third party-verified, green building certifications, and by creating our own Green Financing solutions to serve the US Multifamily debt market. By labeling related mortgages and securities, we are able to capture and track the progress and performance of Green MBS."

Chrissa Pagitsas, Director Green Initiative at Fannie Mae Multifamily.

Innovation in Practice - UBS Asset Management

UBS real estate debt funds are embedded within UBS's Global Real Estate (GRE) business. The portfolio management team has significant direct real estate experience and also utilizes sourcing, underwriting and asset management skills from the GRE equity teams in fully analyzing the assets which are taken as security for loans.

GRE's stated goals are a 20% reduction of greenhouse gas emissions and a 10% reduction of the energy consumption at portfolio properties every 5 years, on a rolling basis. Other quantitative goals include reducing residual waste, increasing the recycling rate above 50% and reducing the water consumption of portfolio properties by monitoring consumption and developing specific water saving measures in different properties. These goals apply to debt and equity funds alike.

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Results release

For GRESB Debt Participants and Investor Members

- Access results via the GRESB Portal today
 - Participants may log-in to view their Scorecards and Benchmark Reports
 - GRESB Investor Members may log-in to request data access to the debt funds in which they invest



Next steps for GRESB Real Estate Debt

Further expansion of services and tools

- Debt Assessment
 - Consultation period begins today
 - Further development of assessment for 2016
 - Open to broader lender participant base
- ESG data access for lenders
 - ESG profile of borrowers/sponsors
- Green Bond Working Group
 - Sharing information and evolving best practices to stimulate green property bond transactions



G R E S B[®]
REAL ESTATE DEBT

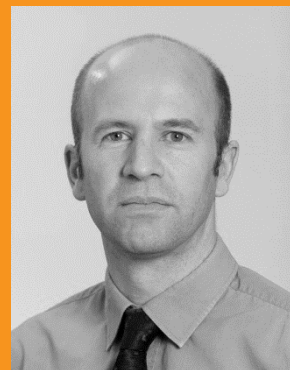
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