Lowenstein Sandler's Real Estate Podcast: Terra Firma

Episode 19:
Going and Staying Green: Sustainability in Real Estate

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Stacey Tyler: Welcome to the Lowenstein Sandler podcast series. Before we begin, please take a moment to subscribe to our podcast series at lowenstein.com/podcasts. Or find us on Amazon Music, Apple Podcasts, Audible, iHeartRadio, Spotify, Soundcloud or YouTube. Now let's take a listen.

Welcome to Terra Firma, Conversations on Commercial Real Estate. I'm Stacey Tyler, senior counsel in Lowenstein Sandler's Real Estate group and deputy chair of our Cannabis practice.

Zach Berliner: And I'm Zach Berliner. I'm a counsel in Lowenstein’s Environmental Law & Litigation practice group, as well as our ESG practice.

Stacey Tyler: Today, Zach and I are joined by Alex Lassiter, CEO and founder of Greenplaces, for a discussion on the growing importance of sustainability in the commercial real estate space. Thanks for joining us today, Alex.

Alex Lassiter: Thank you. Excited to be here.

Stacey Tyler: So, to start things off, can you just give us kind of a general idea of what is sustainability and how does it apply to the commercial real estate context?

Alex Lassiter: Oh, that's a big question. You know, I think everybody probably defines the term slightly different. Historically it was people, planet, and profit. It was this idea that businesses need to be thinking about more things than just the bottom line in order to build a resilient business that lasts. I like to think about sustainability and what I think is kind of the true definition, which is how do you create more value with less resources?

Like how do you create more of what you do with less physical resources, less, environmental resources, less cost? To me, a more sustainable business is one that's more lasting and resilient to change. And I think that's one of the reasons, particularly in real estate, this is so important because so many things are changing about the way that we think about capital planning, energy usage, resource management, people. I mean, all of these things are in so much flux going forward that that resiliency and sustainability becomes very, very important to a portfolio.

Stacey Tyler: Interesting. And I'm sure it's an easy business case to make, to do more with less.

Alex Lassiter: It should be. Unfortunately, sustainability a lot of times is viewed in sort of this austerity lens. Like, if I'm more sustainable, it means that I do, I have to trade off the things that I like, but it's no more different than what you're you know, my mom would tell me when I was a kid, like, shut the door. I'm like, you don't need all of that. Like--

Stacey Tyler: Turn the lights off.

Alex Lassiter: Turn the lights off.

These are not luxuries. These are waste. And like everything else, when you observe, you observe a business or a business unit or a property or whatever it might be. This is just another lens to be able to look at that. And I think it's not it's not an austerity measure. In many cases it should be to provide more value with less resources, not less value with less resources.

Stacey Tyler: That makes sense. And it's something that we're talking about all the time with our landlord clients, because obviously cost saving is just generally something that they strive for all the time. But now we're just seeing a lot more pressure from, you know, the government, from public groups, from shareholders, just to care about sustainability, both for practical cost saving reasons.

But also, just because that's something that now is legally required and something that people are going to want to see before they lease space from you. Can you talk a little bit about do you have landlords that are seeking out your advice on this topic and how they're thinking about it?

Alex Lassiter: Well, absolutely. So, landlords and real estate investment groups are facing regulation from about every possible angle that they could. There's city-based regulation in places like New York and in Chicago soon. There is international regulation that is going to affect the portfolio if you've got locations in different markets.

But more importantly, it comes to the financing arm. So, you've got these banks and investment trusts and limited partners that have made some pretty, you know, key stakeholder commitments around a percentage of their assets that are going towards greener or more sustainable things. And so, the money is locked up. The regulations are locked up and for a landlord, a lot of times they're just trying to figure out the right way to be able to handle this.

It's not the first time they've seen regulation, so they kind of have a way to be able to handle it, but it's absolutely a concern. And I have a ton of empathy for it because it's confusing. And almost every market has a completely different set of rules. And that's one of the things that we find makes things really challenging.

Stacey Tyler: Right. We're seeing this conversation between landlords and tenants now. And as we're negotiating things like operating expenses, and there's all these new compliance metrics and maybe even retrofitting that needs to happen. And it's just, you know, who, if it has to happen, who's going to pay for it.

Alex Lassiter: Yeah. And I mean, I think, you know, I think I think it's going to fundamentally change the relationship between tenant and landlord. You know, one of our, one of our largest investors is Tishman Speyer, for example. Big real estate company. And we talk a lot about how, there's now, for the first time, a lot more interest from a tenant and wanting to understand the energy consumption and the options that they might have to reduce.

So, so take a building in a corporate setting where maybe you've got, maybe you've got a firm like Lowenstein, who's a tenant on the floor. And they've got a commitment to reduce their own emissions. Well, if they don't actually know how much energy is consumed on their floor, it's really hard for them to actually make true on that.

And as they're getting requests via regulation or some of their largest clients and their employees to say we want you to reduce your emissions, they're hamstrung because if they don't actually have a meter that says this is how much we use and they don't have any control, there's not a whole lot of optionality for them to be able to make reductions.

And that, to me, gives an opportunity to engage with the landlord and say, what are the things that we can do to measure, you know, the emissions and the electricity usage and the gas usage on our floor? What are some things that we could do that would lower that? Because in many cases, if you lower your electricity usage, you lower your cost.

And so, I think there's going to be this evolving relationship that occurs over the next five years or so as tenants and landlords have a shared objective now of reducing the, the burden of utilities, and helping each other reach the climate goals that they have. I think it'll be a really interesting change in the market.

Stacey Tyler: Right. And I guess that's something that's more maybe a business cost or kind of an ongoing negotiation. But I want to go back to financing, like you touched on, because I know that's something that, as a business reason, the landlords are constantly having to evaluate if they have to refinance or, you know, if their existing lender has any kind of requirements around sustainability. So Zach, can you talk a little bit about what you're seeing in that space?

Zach Berliner: Yeah. So, I was going to say I, I've certainly been seeing some of this in that space. And I think just stepping back, you know, the building sector is actually, you know, according to certain government information, it's actually the biggest emitter of greenhouse gases among every sector in the U.S. It accounts for buildings and related operations account for 35 to 40 percent of total greenhouse gas emissions just in the U.S.

So, I just think within a broader overall focus on some of these things and trying to combat climate change and hit greenhouse gas emissions, I think that lenders are probably going to become increasingly focused on real estate related investments. Just because of that fact alone, I would say. And so, in some matters that I've been involved in, you know, we've seen, for example, a landlord going to or building owner, a real estate owner going to renegotiate some kind of loan.

And the lender throws in, introduces this whole new rider provision that basically says, you know, look, you have the option to tie performance under the lending agreement or to certain ESG related metrics or sustainability metrics that you set and your performance against those and your ability or lack thereof to meet certain goals that you set for yourself.

And so, you know, like, for example, the idea would be if you set a goal and you don't meet it, then you might get penalized under the loan agreement. Or if you do meet it, then you might get a better rate or some other incentive or benefit that you wouldn't otherwise get. And so, you know, we've been just seeing some clients get thrown something like that for the first time and just having to think about, you know, what is this, what is the implications of this and that it's tied to, you know, a certain set of principles called the sustainability backed loan principles. Then you have to think about how that plays in and, and all of that. So, I just think that this is part of a, you know, growing focus on this kind of stuff in the real estate context, from a lending perspective.

Stacey Tyler: That's so interesting. And our listeners will hopefully remember our, episode recently where we had Wally Kumar on talking about C-PACE lending, which we know is specifically about sustainability. But to hear that general mortgage lenders are also putting requirements on about sustainability is very interesting. It's more reason for our landlords to really have that take a more central role in their asset planning.

Zach Berliner: Yeah, and I think it's tied overall to what we were alluding to before, which is just that the law is really starting to catch up a bit. I mean, my background is more as a traditional environmental lawyer. And of course, there's been, you know, a lot of law. And Alex talking about a confusing patchwork of federal and state and local requirements all over the country.

And that's been that that's the bread and butter of environmental law. You know, each state has their own way of doing things. And that's always been, part of the, the mix in a landlord commercial landlord tenant relationship that we've had to deal with. And it can get very complicated. So, I think in one sense, this stuff is sort of an out, almost like an outgrowth of that, and it'll build on that.

But it is a bit more complex in the sense that the regulatory landscape is not as certain right now. But, you know, be that as it may, there are certain laws on the books in the U.S., like, for example, in California, where companies that generally do business in California, which is a very broadly defined term, if they have basically over $1 billion in annual revenue, which is, which is really just large companies, of course, but those companies then have to report on all of their emissions scope one, two, and three.

And those have specific definitions. But for example, scope three is really any emissions that are in your value chain, you know, up and downstream, not just of owned or operated assets of that particular company. And so that can have pretty important implications in a real estate context, because if you're a commercial landlord or a tenant that is subject to the California law, then arguably maybe the emissions of your tenant or your landlord, depending on how you operationalize it and your relationship and how you see it, could fall within one of your scopes of emissions that could be reported.

But then on the flip side, even if you're a company that's not subject to the California laws, your landlord or your tenant might be, and then they might be approaching you for that information. And so, it's important to think about that in terms of collecting that information for yourself. And that's alluding a little bit to what Alex was saying before, which is, you know, if you're a tenant on one floor, you want to be able to know what your emissions are and be able to track those separately from other tenants in the building.

And on the flip side, it might play into, you know, negotiating a lease and who's responsible for what and all of that and trying to pass along maybe certain costs related to compliance. So, I think what I'm what I'm saying is that it's important to recognize the regulatory landscape. And that really drives a lot of the risk and issues that are important here.

Stacey Tyler: Absolutely. And taking it from the tenant’s perspective, I mean, that's something that we're seeing playing out now. It's a difficult leasing market for anybody who doesn't have a more class A building that is working on these types of green initiatives and that's for all the reasons you're saying it's something that tenants are looking for because they are thinking about these metrics.

And, you know, also because generally that means it's a better building, it's got more recent upgrades and things like that. So, it's just, and it's a tenant wants to be able to say, well, I'm in a LEED-certified building like their clients are caring about that too. So, we're really just kind of seeing it come from all sides.

Alex, do you want to chime in on that? Are you working with any, you know, people who are looking at space in that way from a tenant perspective?

Alex Lassiter: I mean, yeah, it particularly like the much, much larger companies that are looking to expand. You know, we've seen, particularly from businesses that are based in Europe in extremely detail-oriented approach to, like, every decision that they make. And so, I think it's becoming somebody described to me today is it's what's, what's sort of being dragged along in the U.S. is being exaggerated in Europe and I think, what we see here currently is a big move to start to do this stuff more and to take it seriously.

I mean, it's, I think now something like 60, 70 percent of the Fortune 500, I think has a net zero target, for example. And, you know, there's over 1,500 companies in the U.S. that have supplier requirements to, basically, report sustainability. But that's almost nothing compared to what's happening globally. And as those businesses look to expand and come in, we've heard everything from that to requiring conference centers to meet a very rigorous set of standards for sustainability to host an event for some of these companies or asking hotels to fight for RFPs by documenting sustainability metrics. So, I think it's only going to continue to expand as it becomes part of the flow of money.

Stacey Tyler: That's interesting. Can you talk a little bit about the difference in sustainability planning that you need for different types of asset classes? I mean, you know, I'm used to seeing this in the office context especially, but hearing you bring up hotels, that just seems to me like that's got to be tougher for them to meet.

Alex Lassiter: It is. Well, you know, sustainability is not a department. It's a language. I think it's a way that you sort of think about your own business and every business, it's different. But we all have choices that we can make that can align or not align with kind of these objectives. And like anything else, when you weigh a decision, you have to look at it.

So, for a hotel or for a conference center or a restaurant or a car company, they're going to have different ways to look at it. But the funny and I think interesting thing about the carbon accounting, so the, the world of reporting this for a company like Pfizer or Novo Nordisk or General Motors, a significant portion of their emissions comes from these, these businesses that they work with.

So, when they go and they book out a conference center or they hire a law firm or they send people to a hotel for a conference, all of those things add up into it. And so, wherever they put their money, that's actually what their return is, sort of a, they get the emissions associated with that spend.

And so, a lot of times, part of the challenge is sort of, like, communicating to a hotel or somebody in a different class of like, what exactly do we want you to do and what's the standard that you would meet? But there's a significant amount of, like, certifications and standards for all of these industries. There's ISO standards now for sustainable events. I mean, there's enough out there that if people have the intention of doing it, that there's a clear path for them to get there.

Stacey Tyler: So, you're talking a lot about, you know, the types of metrics that people are tracking. Can you talk a little bit about how we should be counseling our listeners to think about doing this? I mean, at what point do you need a sustainability officer? I'm sure some smaller companies might be trying to figure out how they could do this in-house. How do you scale something like that?

Alex Lassiter: Look, it's really complicated. I think it's the first thing I would say. The first step for anybody is to measure. I mean, you can't improve anything unless you measure it. But the funny thing is, once you do measure it, it can become more obvious of like, this is where I need to focus. But the first step is measurement.

And you're right, Pfizer is going to have a chief sustainability officer in a team to do this. Most really big companies like, really, really big ones are. For everybody else, you're in a tough spot because calculating a carbon footprint is complex and very time consuming. You're talking about collecting a ton of different types of data sources from utility information and square footages, receipts, financial documents. There's a ton of stuff that goes into it.

And then the analysis is both complicated, but it also has to involve qualitative information that varies kind of business to business. Makes this really hard. So, what I always tell folks is you kind of have a couple options. You can build out the team which, which I think in the mid-market and down is probably not the right path. It's expensive and it's hard.

The other option is you find somebody like Greenplaces, or a consultant or somebody that can kind of help you with this to kind of get things moving. But I think, I think the biggest thing that I would give to folks is if you're trying to work in enterprise business to business relationships, this is becoming a cost to doing business. I mean, this is a gateway. You can't serve the enterprise. Doesn't matter what asset class you're in unless you're meeting these reporting standards. I think there's too much out there that businesses won't let you into an RFP. You can't win the deal unless you start reporting.

And, you know, that's really where you need to begin. Get a sense of where you are, do your budget and understand where you are in terms of your carbon footprint. And then from there, I think you've got lots of decisions.

Zach Berliner: Yeah. Stacey, I can even speak to that from our own, from my own experience at Lowenstein with this very thing. I mean, you know, there are a lot of motivations for all sorts of sizes of companies, even though, for example, like a smaller company may not be directly subject to any kind of reporting standard, I mean, or requirement or law.

I mean, there's financial and market-based incentives to doing this. And just you get questions from clients, like we've gotten surveys from clients seeking all this kind of information, very detailed technical information about our emissions and our supply chain and where we purchase things from and our energy usage and all of that. And, you know, just bringing it back to a little bit of a real estate context, I mean, it's required collecting a lot of pretty sometimes, often difficult to get or gauge information about our space, you know, like, like approaching our landlords because we lease all of our spaces.

So as a lot of law firms and other service firms do and, you know, it involves having a relationship with your landlord, seeking information from them about your utility bills and how, you know, solid waste and recycling is handled and what those contracts might look like or where things go, and a lot of other information like that.

And so, you know, I think just to Alex's point, this really affects companies of all sizes, even if you're not big enough to have a sustainability officer, a sustainability manager, and a whole team dedicated to it. I mean, I still think that there's a lot of value, even if it's not a purely legal risk perspective, but just from acquiring and retaining talent, clients, business, internal stakeholders, people that work at your company already. It's just important to have a basic understanding and start to track this information because then what doesn't get tracked doesn't get acted on.

So, once you start collecting that information and it won't be perfect in the beginning, but once you start to collect it and improve the quality of that data, then you can have a better vision into, you know, where the low hanging fruit is. You might realize, oh, this is such a big source of emissions, and we could pretty easily address this, and we wouldn't have known this have we not started tracking this stuff?

Stacey Tyler: Had just said, oh, well, that's our landlord's problem and not us. Now it's, you know, we have the onus to pay attention and analyze those things ourselves and it becomes kind of a plus as a marketing perspective that we care about these things, that we're acting on them and we're making our own footprints smaller. I mean, that just becomes an easy business case to make, to build out a team that can help with sustainability.

Zach Berliner: Or at least that you're starting and thinking about the journey. You know, the sustainability journey.

Alex Lassiter: Yeah, for sure. This was an interesting sort of, I think way to kind of bring it back. Yesterday we were we were talking with, with the chief sustainability officer of General Motors who has some very, very specific climate guidance for any supplier of the company. And they're not alone. There's thousands of these businesses that have set clear guidelines that say if you want to work with us, if you want to be a supplier, you have to meet these obligations, report your footprint, tell us how you're going to reduce all that type of stuff. And, when we asked and we said number one, what does it say if somebody doesn't participate, if one of your suppliers does not actually fill out the survey and provide the information?

The answer she gave was number one, you cannot be a supplier of choice without doing this. And number two is that sends a very strong message to our business when we've determined that, you know, one of our core values is going to be in this category. It's going to be a core thing of who we are.

If you're not going to be aligned with us on that, that sends a strong message to us about you as a partner going forward. And when we dug deeper, we were asking about, what is it like, what's the, you know, what are the driving reasons behind this? Is it to meet some compliance requirements? They obviously have compliance and regulations, she said.

No, you need to be thinking about sustainability as resiliency, and that's how we think about it. The questions we asked people, she said, if you if you thought about this in the way that a business might assess a factory for safety. When we walk into a factory, we're looking for like, like, you know, Six Sigma, cleanliness, all of that type of stuff.

That's how we evaluate our vendors, that's how we evaluate our suppliers. And when we walk into a factory and they haven't met those compliance requirements for safety, it doesn't just tell us about the factory, it tells us about the management and how does the management of that company, looking at all of the different things that could happen to them in the future, and are they prepared to do it?

So put differently, in the context of a real estate portfolio, somebody not reporting this type of stuff is admittedly not looking at information that is going to absolutely be impactful for them on a number of different scenarios going forward. And it may not be specifically climate, it might be water, it might be resourcing, it could be political stuff, it could be all kinds of things.

But businesses have to be forward thinking, and they've got to be able to look at a bunch of different scenarios of how can this affect my investment. If I've got a bunch of properties that were previously listed as an A investment, but depending on how climate change changes, are not. If I'm not even thinking about that stuff, is that an asset you'd invest in? And it probably wouldn't be.

So, part of the impetus for people doing this is it's not just about the dogmatic, like, we want to save the planet. Certainly, I care about that. But the reason that investors look into it is because it is a metric to be able to judge management readiness for future scenarios. And that's the way that I would think about it if you're a listener of this is how do I demonstrate to somebody that I'm considering a lot more about how the future is going to look than it does today? And doing this type of work allows you to assess your footprint, but more than anything, it starts to allow you to assess risk and business resiliency. And it starts to build in these motions where a management team can be a stronger partner for somebody going forward, to be a stronger investment, be a stronger, law firm, whatever it might be.

So that's the that I just thought that was just an interesting point, because I never really had made that connection to resiliency. But her point was the last 5 or 10 years in automotive segment, the supply chain has been like nothing they've ever seen. And 10 or 20 years from now, it's only going to get more difficult to assess and they need business owners who are thinking about all of the different scenarios that can impact their business. And this is a way for them to start to do that and demonstrate it.

Stacey Tyler: That's fascinating. It's, this is not just an add on optional program. This is just part of the baseline as being seen as sophisticated.

Alex Lassiter: She said it, she said it, you plainly, you cannot be a supplier of choice in the Fortune 500 if you don't do it. It doesn't matter what category you're in, it doesn't matter, you know, you don't have to manufacture something. I mean, it is explicit. We've had we've had clients who are like, we have a client who does office furnishings.

They were not let into an RFP with a major company to supply the furnishings for their office unless they can meet this rigorous amount of reporting. Just simply put, they could do everything else. They could not do this unless they had that. And that happens more and more and more and businesses that are not doing it today, admittedly, are refusing to look at information that their clients really value and care about because not just the environment, but the resiliency, the preparedness, and the analytical thinking that comes with building a successful business in the next, you know, 10 to 20 years. It's just incredibly important across so many ranges of things.

Zach Berliner: And, and I think that it's important for all those really, really well articulated reasons. It's important to solicit that information and to ask for it in the context of like a real estate transaction, right. Because if you're looking to acquire a huge property that might really change or have a pretty big influence on your real estate portfolio, you'd want to know all this stuff about the resiliency of the building and how it's been operated, so that you're not unintentionally or accidentally, you know, harming your ability to attract business and financing and all of that.

So that's why since in some of the deals that I've worked on, we started to try to probe these risks and these matters, you know, asking about if you have certain goals or a sustainability plan or what your greenhouse gas emissions are or at least, you know, in a, again, in a more traditional environmental context, right?

Like if you purchase a property, you would do what's called a phase one environmental site assessment, which is someone goes to the property, they look around, they take pictures. They try to get a gauge for any visual, visually obvious environmental risk. And, you know, I think it's a similar type of concept. You want to be able to understand what that the risk of that building poses in this area and the sustainability area just like it poses in any other area that you would probe and diligence before closing on a transaction.

Alex Lassiter: And think about it, it is exactly right, Zach. Like, I think, you know, even if you don't care about it, right, even if it's something that isn't important to you, if you're buying a real estate asset and your plan is to exit that asset in the future, you're closing off your capital pool by selecting a property or selecting an investment that doesn't comply with those things, you're closing an asset pool that could be your next financing option.

You're shutting the doors on things that you don't have to. And as Zach mentioned, if your property itself will be less attractive in the future and you had the—the thing is, today the data is available. I mean, you're going to need help. Like we can help you. I mean, a company can help you like ours or somebody else can help you get the data, but the data is available.

So knowing that strengthens your ability to find better investments, to get better returns, to attract better, better tenants, to create more profit, to create more value. All of these things, the data is there. You've got to be looking for it. And it's different I think, I think the next 10 to 15 years will probably be the largest exponential growth of risk assessment in the last 50.

And it will affect, it's going to affect everything. But the, the risk of any investment going forward is much higher than any investment historically, in my opinion, over the last 10 or 20 years because the models don't work as well, because there's more factors at play, because businesses are more global, they're more distributed, because people care about different things.

There's so many different things and you've got to be able to look at it from that risk mindset to say, you know, am I going to make wiser decisions in the future? And the only way to make wiser decisions is to get more information. And this is just, unfortunately, a big category of places that businesses still have a blind spot, and they don't have to be. That's the way I would sort of think about it.

Stacey Tyler: Well, hopefully that convinces our listeners that if they don't already, they really need to care about sustainability and start devoting some real time and resources to that entire area.

Alex Lassiter: Just start measuring, just start collecting data. And if you if you're trying to figure out what data do I collect? Zach is a total expert on this. He's a perfect person to talk to. And the rest of the team at Lowenstein, Greenplaces, greenplaces.com, we're more than happy to help you. You don't have to buy something for us to be able to help direct you in the right place.

There's plenty of people out there who can help you navigate this stuff, but ignoring it is not an option anymore. And just start the process of getting it together. Like get your data together. Once you have it, you can make good choices, but without the data, you have no idea what monsters are lurking and you're just running blind for, frankly, no reason and your competitors are not. So go get that edge today and get more data, get more visibility, and you'll be able to outperform the market. That's the only way that you're going to be able to do it.

Stacey Tyler: Well, you heard it here, listeners. Get it together.

That about wraps it up for us today. Thank you, Alex, so much for joining Zach and me and helping our listeners get smarter about sustainability. And thank you, listeners, for tuning in today. Be sure to like, subscribe, and follow Terra Firma wherever you're listening to this episode. We'd love to hear from you, so feel free to reach out to us at TerraFirma@lowenstein.com.

And until next time, ciao!

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