How ESG Contributes to NOI in Multifamily

Connectivity strategies underpin broader objectives of environmental sustainability and resilience and are beneficial in achieving lower insurance costs and higher net operating incomes at multifamily communities.

By Alison L. Johnson / *NMHC* and Valerie M. Sargent / *Broadband Communities*

In this issue of **Broadband Communities**, which focuses on economic development, we want to further explore a topic we covered at the **Broadband Communities** Summit for the first time this year: sustainability, and how a company's sustainability and operational goals intersect with asset management and connectivity strategies.

A property's digital backbone plays a vital role in realizing environmental goals. New intelligent building technologies and systems are eco-friendly capital investments that apartment managers can use to save on costs, mitigate risk and support data management of building energy performance. Though every building is different, leveraging new technologies for facilities control and managed services can generate net operating income (NOI) benefits and collect whole-building data that helps property owners make informed decisions about property and portfolio performance.

There are key reasons focusing on environmental, social and governance (ESG) has become a priority. ESG is a framework used to assess an organization's business practices and performance related to various sustainability and ethical issues. Though capital interests sit at the top of the list for many companies, addressing the physical and financial risks to assets climate change causes gaining influence within the real estate sector. Why is this important to the multifamily industry, and why should owners take notice? Simple: insurance rates and investment risks and returns.

THE RISE OF ESG

In March 2022, the U.S. Securities and Exchange Commission (SEC) proposed new rules requiring that public companies in the U.S. disclose certain climate-related information in their annual reporting. Although the agency has yet to publish a final ruling on the disclosure requirement, the number of real estate investment trusts (REITs) reporting this information since they first started sharing ESG data publicly increased.

In 2017, only 60 REITs published ESG data publicly. That rose to 22,200 REITs publishing ESG numbers, according to the National Association of Real Estate Investment Trusts. These are public companies that now voluntarily disclose their environmental stewardship goals. There are also privately held companies putting the same dedication into publicizing this information regarding their new development and/or redevelopment projects.

When a company produces ESG data, it shows what it deems important. A strong ESG proposition can create value for a company brand, reflecting that it is a good corporate steward and considers environmental, social and governance concerns. The environmental aspects address energy that a multifamily community takes in, the waste it discharges and any resources it needs. It can also address climate change and carbon emissions and their impact on the environment. Social criteria focus on how the property and the company operate within society and the reputations diverse relationships with individuals, institutions and local communities where business is conducted build. Last, the governance portion addresses the policies, procedures, practices and control measures the company uses to govern itself. All can be powerful persuaders in attracting insurers, investors and residents.

RISK MITIGATION

In 2009, the Global Real Estate Sustainability Benchmark (GRESB) was established to identify factors that investors can use to reliably measure a company's performance in evaluating environmental risks and taking steps to mitigate them. Begun by a handful of values-driven investors, the benchmark is now used by more than 170 leading institutional and financial investors to monitor investments, engage with real estate managers and make informed decisions. Though GRESB usage is embedded in the investment evaluation process, there is still much skepticism about the relationship between adoption of sustainable best practices in real estate and financial performance. How is it possible to assign materiality to something that has not traditionally been viewed as having intrinsic financial value?

The good news is that there is now enough data in the world and enough financial investors who care about ESG and have been investing this way that longitudinal studies focused on ESG can be done. In 2021, researchers looked at the relationship between ESG reporting and financial performance by examining sustainability efforts reported to GRESB and the Fund Index – Open End Diversified Core Equity (NFI-ODCE). The study showed that over the course of time, that fund has performed better than market peers, indicating that it is indeed possible to realize financial returns through this practice. This is but one study of many sure to come.

What about insurance rates? A McKinsey & Company article, "Capturing the Climate Opportunity in Insurance," puts it well: "The world is at an inflection point in its climate transition efforts. As governments and companies worldwide pledge to achieve net-zero greenhouse gas emissions, the transition is poised to spark the greatest capital reallocation in a century, requiring an estimated annual investment of more than $9.2 trillion in energy and land-use systems. It's a transformational moment for insurers, with significant climate-related risks and opportunities on both sides of the balance sheet. Taking an offensive approach will be critical for insurance carriers to unlock growth and remain relevant in a net-zero future."

The National Multifamily Housing Council (NMHC) recently published its 2023 State of Multifamily Risk Survey and Report – a comprehensive review of current insurance market and risk mitigation strategies that multifamily businesses need to understand and consider. Of many eye-opening details concerning insurance in the report, the confirmation that property insurance costs rose a staggering 26 percent on average for multifamily companies over the past year highlights how environmental risk factors impact housing providers.

A strong ESG proposition can create value for a company brand, reflecting that it is a good corporate steward. Research shows it also creates financial returns.

HOW DOES ALL OF THIS AFFECT MULTIFAMILY COMMUNITIES?

Though many real estate companies have strong sustainability practices and programs, the demand for information and data tracking of climate change mitigation efforts by regulators, investors and risk managers will transform business practices.

What does this look like in the real world? As discussed during the recent **Broadband Communities** Summit, a multifamily owner or operator may already be on the ESG journey, having integrated on-site and portfolio assessments for reducing energy demand, creating efficiencies where possible or pursuing on- and off-site renewables. Such initiatives could have a multifamily community powering all communal spaces with energy from typical sources, such as the local energy company, and then installing energy-efficient thermostats to monitor and control temperatures when people are not home. It can involve water sensors to help guard against leaks while also ensuring water is heated properly. How does heat emanate from a building in the summertime when the sun hits it? Painting a roof white instead of black can help the roof refract the light and no longer absorb heat. That keeps the building cooler, and residents don't need to run their air conditioning as much. This can help prevent strains on power grids.

New management and monitoring systems are going to be IoT devices that communicate. If a home or building owner buys new equipment, it's going to connect to something to transmit and receive data for analysis and insights, so the proper infrastructure needs to be in place. That means thinking about the building wires in use and monitoring, managing and protecting data. Owning the network provides flexibility in adding what is needed, and partnering with a broadband provider that can help manage all smart-home related technology can help ease the process.

Incorporating sustainable factors into building audits and assessments remains an important way to look for opportunities for capital investment in new facilities. That said, addressing climate-related risks requires more investigation and investment than energy and water monitoring. If an organization wants to proactively address these risks, senior leaders need to understand and work in partnership toward an integrative environmental risk mitigation strategy.

Most greenhouse gas (GHG) emissions are industrial and from industrial sources, but commercial buildings such as multifamily communities now contribute between 10 to 12 percent of GHGs. Certain states – Colorado is one – have their own net-zero goals for the entire state. This means that if a company is trying to sell a building in that state, having certain ESG efficiencies in place makes a property more attractive to buyers and investors. In addition, a company based in that state may be less likely to purchase a community in another location that does not focus on ESG.

- **Research** – Gather information about state and global regulations, and anticipated federal regulations and industry-specific benchmarking programs to understand the metrics and reporting provisions being created.
- **Assess** – Know your company's climate-related physical and transitional risks. Conduct greenhouse gas inventories of your properties.
- **Identify** – Determine and set clear goals to work toward. Consult

with your broadband partners, risk managers, insurers and others to discover which solutions best fit your company's operations and business model.

- **Communicate** – Establish protocols for sharing targets, disaster and crisis preparedness, and scenario planning with employees, industry partners, reporting entities, shareholders and community stakeholders.

In the wake of the pandemic and ongoing climate change concerns, ESG took on greater significance, and companies are taking more active roles in building a sustainable, resilient future.

Technological solutions lead the way for a transition to integrated planning and reporting of ESG goals. These new technologies contribute value to properties *and* can be appreciated by insurance and investors. Doing anything to address physical risks in an asset demonstrates positive action – initiating ESG and climate-risk mitigations preserves finite resources and creates value for investors, residents and companies. Action is viewed as better than inaction, and there is more faith that the asset will survive and that the company is a better risk. When risk is mitigated, insurance costs go down rather than up, and companies can save money and have a higher net operating income. This creates a win-win scenario for all: insurers, investors, residents and the climate.

Alison Johnson is associate vice president, content and program strategy for the National Multifamily Housing Council and can be reached at ajohnson@nmhc.org.

Valerie M. Sargent is a multifamily speaker, trainer and executive consultant, and the multifamily news correspondent for **Broadband Communities**. *Contact her at valerie@bbcmag.com.*

For more information, visit www.nmhc.org, www.bbcmag.com or www.valeriemsargent.com.