

## Market Views

- Analyses and updates from the Norwegian real estate market

December 2022

# ESG: From Ambition to Action

## ESG: Future requirements

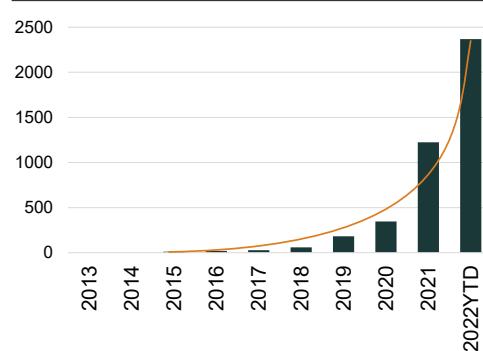
### The Frameworks landlords must know of

- Issues surrounding environmental, social and corporate governance (ESG) are more important than ever. Companies are having to respond to heightened expectations amongst investors, tenants and employees, and are setting themselves high ambitions.
- Nonetheless, most of the work remains outstanding. Property owners and investors are citing a lack of guidelines, quality-assured/comparable data and demand, as well as a limited willingness to pay amongst tenants.
- As the authorities are tightening the rules on ESG reporting, many companies will soon be forced to step up their efforts in order to be compliant.

## A jungle of acronyms - we decode



## Exponential increase in companies committing to the Paris agreement

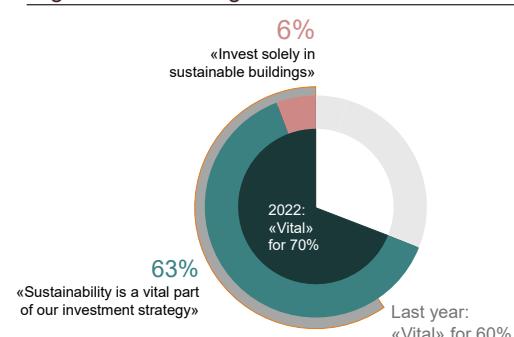


## Akershus Eiendom's ESG surveys

### Green ambitions higher than last year

- Our latest sustainability surveys show that environmental ambitions in the property market have continued to grow from last year's high.
- No fewer than 70 per cent of property investors say that sustainability, in the broad sense, is vital to their investment strategies. This is primarily driven by the belief that tenants will demand green premises in the future.
- Over half of all tenants in the survey say they are willing to pay for pioneering green premises. As brokers, our experience of the current market is that most tenants seeking new space are not as ambitious once words must be turned into action. We expect this to change following new regulation.

## High ambitions for green investments



## Leasing market: Gap between ambitions and action

**57%**

of surveyed tenants reports having increased willingness-to-pay for leading sustainable buildings

## New frameworks | What landlords need to know

Many companies have set high sustainability ambitions and have a strong desire to make a difference. Yet most of them still have a long way to go. As the authorities are tightening the rules on ESG reporting, many companies will soon be forced to step up their efforts in order to be compliant. Positioning properties for future demand will be important.

The World Economic Forum (WEF) estimates that buildings account for some 40 per cent of global carbon emissions. Around 85 per cent of buildings that will be in use in 2050 have already been built. This means that a major part of the challenge lies in improving the existing building stock. At the same time, we are seeing a wave of urbanisation where most of the development is taking place in urban areas, meaning that the decarbonisation of cities will be the main priority.

A lack of guidelines, ambiguous definitions and varying data quality have meant that few have seen the value of taking action. New EU reporting requirements are about to come into force. CSRD will broaden the scope of the reporting requirements and the range of reporting entities. The number of companies obliged to report on sustainability will increase from 12,000 today to 50,000 from 2026. The companies have to report not only on how sustainability factors can pose a financial risk to them (financial materiality) but also on their own impact on people and the environment (impact materiality). External certification by auditors or other insurance providers along with clear and consistent criteria for what is considered “green” will make greenwashing more difficult. It will lead to more transparency and improved data quality. We take the view that the introduction of CSRD, SFDR and the EU taxonomy will usher in wider demand for green buildings in Norway.

## ESG surveys | Will high ambitions lead to action?

Building owners and property developers have high ambitions for their green investments. No fewer than 70 per cent of property investors say that sustainability, in the broad sense, is vital to their investment strategies. According to our analyses, these ambitions are largely driven by the belief that the rental market will begin to demand green properties.

In the transaction market it is now almost routine to include a chapter on ESG in the prospectus in order to underpin a green business case. Our survey found obvious reasons why this is important in the sales process. As many as 93 per cent of investors say they are willing to pay more for pioneering green buildings. For that reason we are seeing green value-add strategies growing in popularity amongst dedicated ESG funds, including in Norway. Their business model is to acquire energy-inefficient buildings, make them energy-efficient using sustainable

materials, and exploit the green upside in both the rental and transaction markets. Seemingly ordinary value-add strategies are thus given a new green value driver.

Tenants also have relatively high ambitions, but only a few are putting their money where their mouth is at present. As an example, more than half of respondents say they are willing to pay for pioneering green premises. Yet speaking from a broker's perspective, the majority of tenants looking for property are not as ambitious once they have to turn words into action – at least not for the time being. This is likely to change once four to five times as many companies begin statutory sustainability reporting between 2024 and 2026. Until then it is the largest Norwegian companies, and international firms with regional offices in Norway, that will continue to demand green properties and are willing to pay for them.



# ESG in real estate: Future requirements

by Camilla Hvistendahl and Kari Due-Andresen - Akershus Eiendom

A major maturation process is underway in the property sector when it comes to sustainability. Ambitions are very high. Yet most of the work remains outstanding. As the authorities are tightening the ESG reporting policies, many companies will soon be forced to step up their efforts in order to be compliant. Positioning yourself for future demand will be important.

*In this article we will be looking at the concepts you need to be familiar with as the green shift gathers pace*

## Background

Last month the global population surpassed 8 billion people. We spend almost 90 per cent of our time indoors. It comes as no surprise, therefore, that buildings account for a large proportion of the planet's energy consumption and carbon emissions, both during construction and when in use. This presents us with both challenges and opportunities. One thing is certain, however: the property industry will play a key role in the battle to reach the ambitious sustainability goals that have been set both globally and locally.

Issues surrounding environmental, social and corporate governance (ESG) are continuing to gain traction, and companies are having to respond to heightened expectations amongst investors, tenants and staff. Navigating the jungle of sustainability acronyms is tricky, to say the least: ESG, BREEAM, NZC, NFRD, CSRD, SFDR, GRESB, PRI, IPCC, TCFD are but a few of them. During 2021 we noted a sharp rise in the number of clients raising the issue of sustainability with us. This was also the start of a wider initiative by Akershus Eiendom to identify supply, demand, current status and maturation amongst property owners, tenants and banks.

Figur 1: ESG - an overview

Content  
to be included in  
sustainability  
reporting

## E<sub>nvironmental aspect</sub>

- Climate change effects
- Greenhouse gas (GHG) emissions
- Loss of biodiversity
- Deforestation
- Contamination
- Energy efficiency
- Water management

## S<sub>ocial aspect</sub>

- Employee safety and health
- Working conditions
- Diversity
- Equality and inclusion
- Conflicts and humanitarian crises

## G<sub>overnance aspect</sub>

- Corporate governance as prevention of bribery
- Corruption
- Diversity in management
- Online security and privacy practices
- Management structure

We find that many businesses have high ambitions and a strong desire to make a difference. Yet most of them still have a long way to go. In this month's analysis we want to shine a light on sustainability. In the interest of clarity, we should stress that the main focus will be on the environmental aspect, i.e. the E in ESG. The findings from our surveys are presented in part two of the report.

## Why should we care?

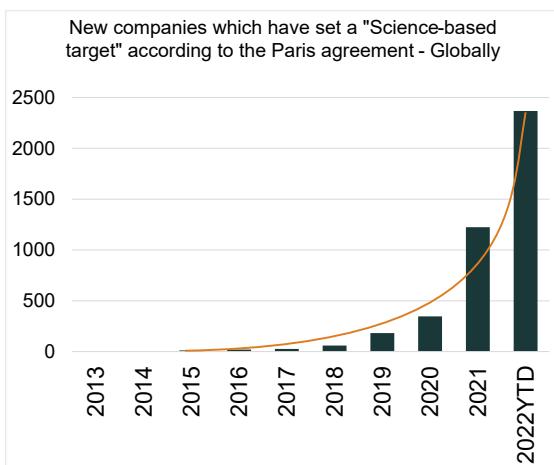
The obvious answer is that it is the right thing to do. The World Economic Forum (WEF) estimates that buildings account for some 40 per cent of global carbon emissions. In urban areas this figure is far higher, with the built environment accounting for up to 60 per cent of all emissions. What is more, around 85 per cent of buildings that will be in use in 2050 have already been built. This means that a major part of the challenge is to improve the existing building stock. At the same time we are seeing a wave of urbanisation where most of the development is taking place in urban areas, meaning that the decarbonisation of cities will be the main priority.

In Norway, close to 60 of the country's leading property owners and developers have committed to ten green immediate measures (Nw. "Strakstiltak") drawn up by Eiendom Norge and Grønn Byggallianse. A year ago, a further ten measures were launched (version 2.0). The measures contribute to, among other things, achieving a climate-neutral Norway by 2050, closed material cycles (circular economy) and zero emissions of greenhouse gases (GHGs) in 2050, as well as increased biological diversity. There are also examples of several players who voluntarily participate in other national and international reporting frameworks such as BREEAM and GRESB. Some do this in line with the company's overall strategy. Others to satisfy investor expectations and requirements. There are also examples of companies that have prepared their own carbon budgets to reach "net zero", such as NREP with their much-discussed

internal carbon tax.

Yet many property owners are hesitant to invest in major (and costly) sustainability initiatives. Owners point to insufficient demand and willingness to pay amongst tenants. Investors blame the lack of quality-assured data and trustworthy benchmarks. With stricter and more standardised reporting rules, more transparency, and improved data quality, we expect to see a big leap in demand and tenant expectations in the coming years. New EU reporting requirements are about to come into force. Given the exponential increase in multinationals committing themselves to EU science-based targets under the Paris Agreement, one would expect the change in demand for green buildings could happen relatively quickly, including in Norway. Property owners and developers will be forced to adapt.

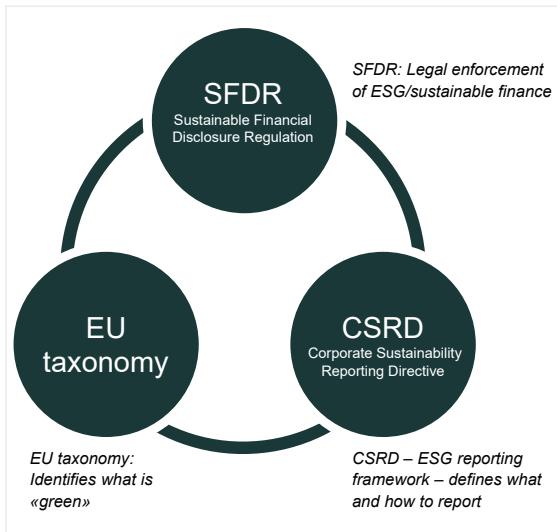
Figure 2: Exponential increase in new companies committing to the 1.5 degree target



## 2023 – the Green Deal comes into force

The European Commission's green growth strategy, the Green Deal, aims to make the EU climate-neutral by 2050. The EU has introduced a raft of regulations as part of this drive. The three most important are the Sustainable Financial Disclosure Regulation (SFDR), the EU taxonomy and the Corporate Sustainability Reporting Directive (CSRD), which will replace the non-financial reporting directive (NFRD).

Figure 3: EU sustainability framework



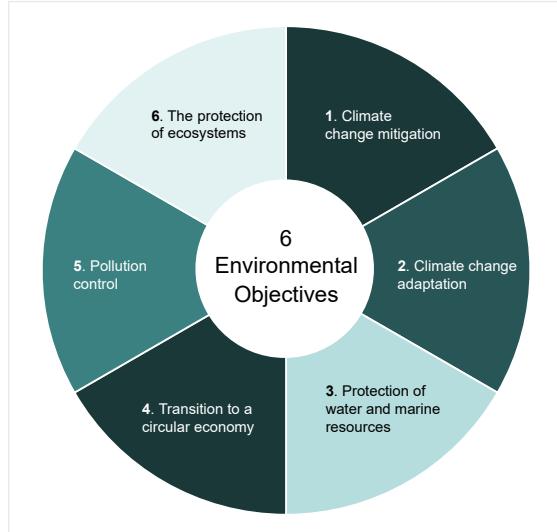
The Norwegian Ministry of Finance has announced that the Sustainable Finance Act, which incorporates the EU taxonomy and SFDR into Norwegian law, will only come into force in 2023 rather than in 2022 as previously thought.

## EU taxonomy

The EU taxonomy is a green classification system which sets criteria for which activities can be deemed sustainable. One of the criteria is that the activity must make a substantial contribution to at least one of the EU's six environmental objectives while not causing harm to any of the other objectives. This could result in complex situations. For example, a newly constructed green building could help reduce greenhouse gas emissions when in use (objective 1). However, if an existing, usable building was demolished in order to build a brand new green building, this could negatively impact the transition to a circular economy (objective 4).

Although the taxonomy only covers financial businesses, listed companies and companies with 500+ employees, the rules will also come to affect operators in the property sector. Financial providers offering products that promote the sustainability goals must also report.

Figure 4: EU's six environmental objectives



## CSRD – A «game changer»

Once this framework is in place, organisations can no longer simply rely on enthusiasm and ambitions to reach their sustainability goals. CSRD will broaden the scope of the reporting requirements and the range of reporting entities. The number of companies obliged to report on sustainability will increase from 12,000 today to 50,000 from 2026. We take the view that the introduction of this directive will usher in wider demand for green buildings in Norway.

### The main changes:

#### More businesses will have to report

- Sustainability information must be audited
- More detailed specifications of the reported information and reporting in line with obligatory European sustainability standards
- All information to be published and disclosed as part of the annual directors' report

CSRD requires “double materiality” reporting. This means that businesses must report not only on how sustainability factors can pose a financial risk to the business (financial materiality) but also on their own impact on people and the environment (impact materiality). External certification by an auditor or other insurance

provider along with clear and consistent criteria for identifying impact and materiality will reduce the risk of greenwashing.

CSRD expands on the EU's rules on sustainability reporting. It applies to all listed companies and large companies operating in EU-regulated markets meeting two of the following criteria:

- $\geq 250$  employees
- $\geq \text{EUR } 20$  million balance sheet
- $\geq \text{EUR } 40$  million net turnover

The widened scope is expected to come into force in 2023. It will have a major impact on more than 50,000 businesses in the EU and Norway, many of them property companies.

[See page 7 for a timeline of current and future sustainability frameworks](#)

## Sustainability in practice

Leading property companies are very well placed to make a difference: firstly by collecting and analysing building use data, secondly by considering solutions and possible measures to promote resource efficiency, and finally by applying sustainable practices and materials

when implementing the measures. Data sharing and cooperation between owners and tenants are key to achieving the best possible outcomes. Many people opt to resolve this with green leases.

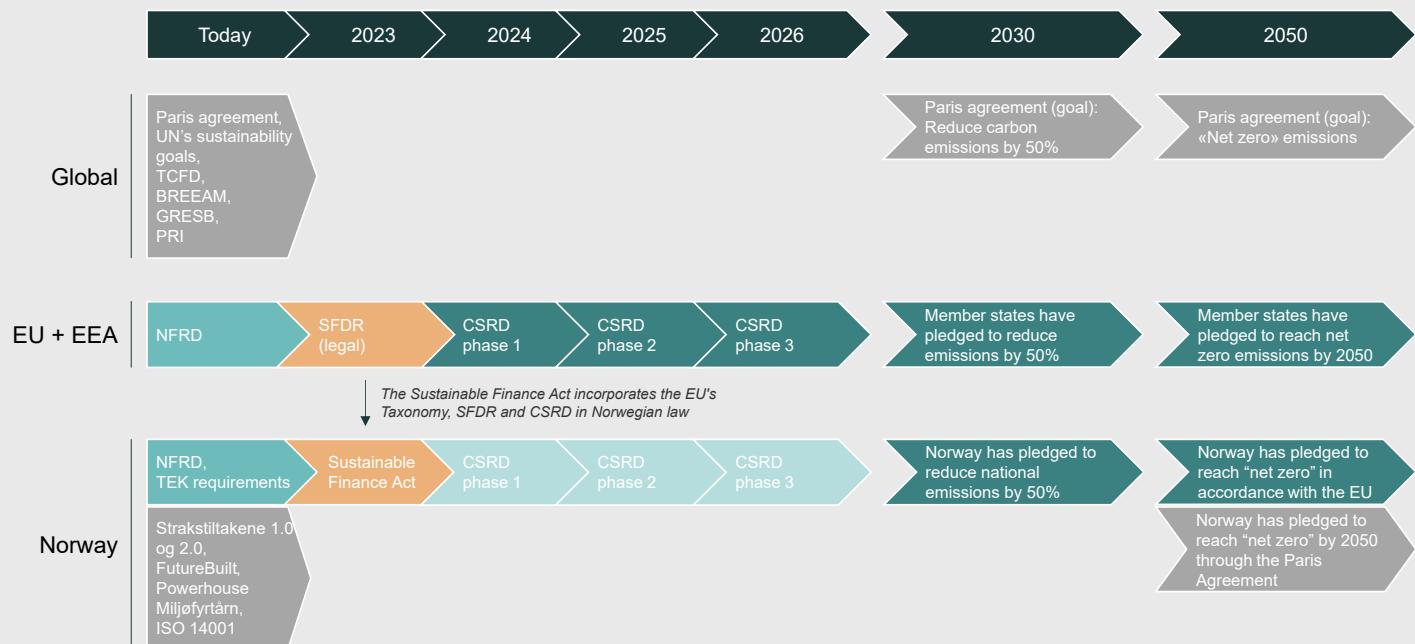
We are seeing that many property owners are going for low-hanging fruit in order to make their portfolios more energy-efficient. Higher electricity prices have accelerated tenant demand for simple efficiency measures. One respondent to our survey explained that by replacing the light bulbs in a warehouse building with LED lights, they achieved a 20 per cent reduction in electricity consumption. Our partner JLL has produced an in-depth guide on how to best reduce the carbon footprint of existing building stock [Les «Retrofitting Buildings to be Future-fit – The journey to decarbonization» her](#). Even though many businesses are already doing this, JLL's technical consultants recommend considering more wide-reaching measures before starting retrofitting.

## Opportunities for shared value

Climate commitments increasingly lend themselves to shared incentives between investors and occupiers



## Timeline: Current and future frameworks for sustainable activities



# ESG: High ambitions, but will words lead to action?

by Sindre Vesje Bråtebæk and Kari Due-Andresen - Akershus Eiendom

Our sustainability survey shows that environmental ambitions in the property market have continued to grow from last year's high. Where a decade ago only a handful of pioneers were acting on their concerns about the environment, we are now seeing almost all property investors and developers putting climate and sustainability on their agenda. But will the words lead to action? And are tenants sufficiently keen on green buildings?

## Framework and key findings

Every year Akershus Eiendom conducts three surveys on sustainability in the property market.

Part 1) Almost 100 property investors with assets of more than NOK 800 million between them report having high environmental ambitions. This year's survey revealed an increase on last year.

Part 2) Twelve of Norway's leading banks report offering increasingly advantageous terms for green loans.

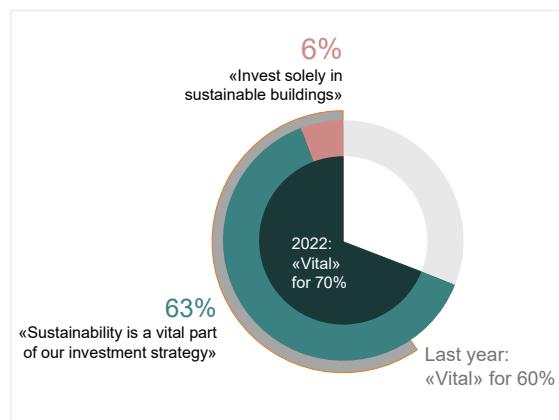
Part 3) Tenants with combined office demand of 200,000 sq. m. currently searching for office space report surprisingly lacklustre demand for green property at present, yet they are highly confident that this will become important over the next five years.

JLL has also carried out several global surveys reflecting our findings in Norway.

## Investor's environmental motivation

No fewer than 70 per cent of property investors say that sustainability, in the broad sense, is vital to their investment strategies. This is an increase of 10 percentage points on last year's survey.

Figure 1: Sustainability in investment strategies

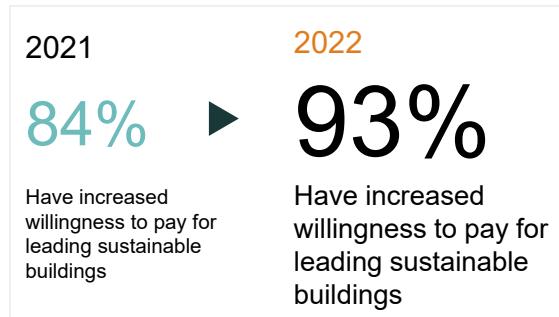


In the transaction market for commercial property it is now almost routine to include a chapter on ESG in the prospectus in order to underpin a green business case. The environmental aspect is used as a selling point for existing green

buildings. Less eco-friendly buildings are being marketed with a path to decarbonization.

Our survey found obvious reasons why this is important in the sales process. As many as 93 per cent of investors say they are willing to pay more for pioneering green buildings. This is an increase on last year's survey.

Figure 2: More investors have increased willingness to pay for innovative sustainable buildings than last year



Too few green buildings are generally introduced to the market for investors to be able to buy a green portfolio outright. For that reason we are seeing an influx of dedicated ESG funds and green value-add strategies growing in popularity amongst, including in Norway. Their business model is to acquire energy-inefficient buildings, make them energy-efficient using sustainable materials, and exploit the green upside in both the rental and transaction markets. Seemingly ordinary value-add strategies are thus given a new green value driver.

### The fear of stranded assets

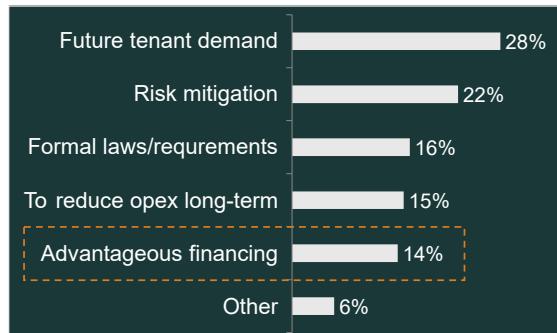
What is driving this green wave in the transaction market? Has the normally conservative property sector become environmentalists?

The answer is that most investors believe tenants will demand green premises in the future. The rental market will therefore act as both carrot and stick. The carrot is the way in which the best green buildings can achieve a green premium – they create a business opportunity. The stick is the risk that energy-inefficient properties end up as stranded assets for which there is no demand.

Avoiding stranded assets is now high on the agenda for many international fund structures. They are drawing up extensive renovation plans for their properties and including emissions data for each upgrade in their investment budgets. This way they ensure that their portfolio is clearly geared towards the 1.5-degree goal of the Paris Agreement.

The figure below demonstrates how the aforementioned carrot (demand) and stick (risk of stranded assets) in our survey were reported to be the key motivating factors for green investments.

Figure 3: Why is sustainability a part of your investment strategy?



The summary above also shows that advantageous terms for green loans are some way down the list. This brings us to part 2: The banks.

### Green loans - Increasingly better terms

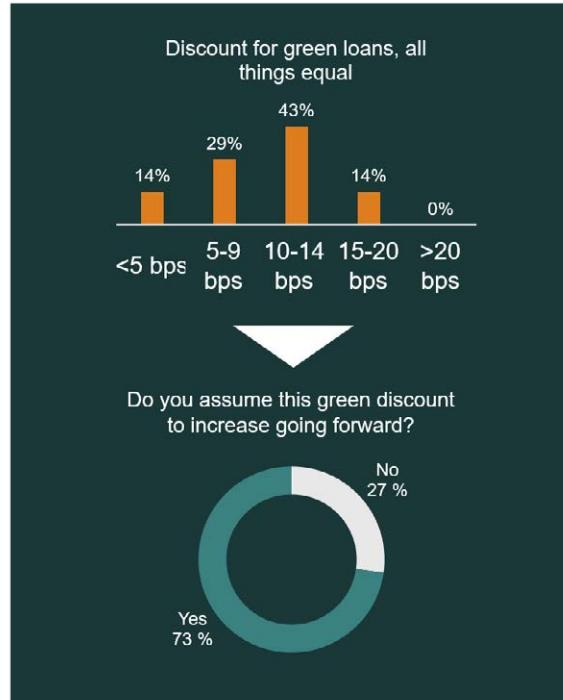
The banks have high ambitions for their green financial products. Several banks say they were offering green products more than five years ago, but the majority of them started offering green loans in 2019-20.

The biggest change from last year's survey is that 86 per cent of banks now say demand for green loans is too low for them to be able to realise their green lending ambitions.

This year's survey also found that the discount on green loans, all other things being equal, increased between 2021 and 2022. The average

discount is now just over 10 bp compared with just under 10 bp last year.

Figure 4: Green loans are more advantageous than last year, and banks expect the trend to continue



Three quarters of the banks think the discount will increase over time. Banks are currently unable to recover this discount through their borrowing rate. They must therefore take the hit from these lost earnings directly on their own bottom line. With stricter rules on what is considered “green enough” being introduced by the EU taxonomy, 80 per cent of banks believe that this particular problem will ease and that the difference between green and ordinary loans will increase.

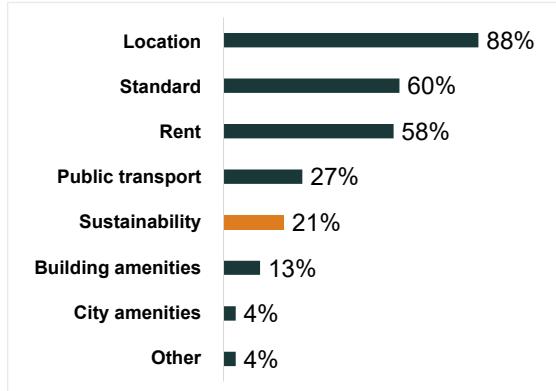
### Tenants: Demand for green properties only began in earnest in 2021

Green ambitions amongst property investors are thus primarily driven by the belief that tenants will demand green buildings. But do they?

Our analyses show that the answer to that over the past 8–10 years has been yes, but no. We found no significant increase in the number of tenants willing to pay more for the around 140 new BREEAM-NOR-certified office buildings

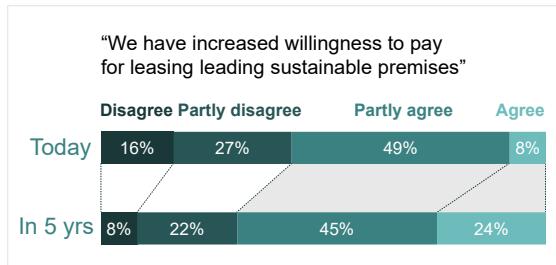
developed since 2012. At the same time we are noting that energy efficiency and sustainable materials tick several boxes for tenants, yet other factors remain more important in the end.

Figure 5: Tenants top criteria when finding new office space (Method: choose three)



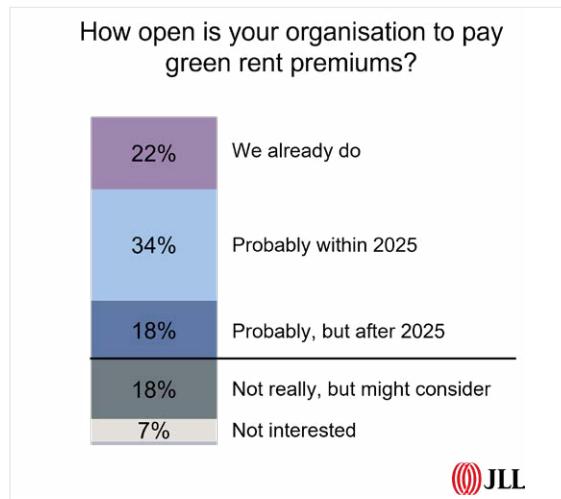
Demand is however slightly moving in the right direction. As an asset manager would say: “past performance is no guarantee of future results” The companies do in fact say they are willing to pay for green leases:

Figure 6: Willingness-to-pay for green leases in Norway



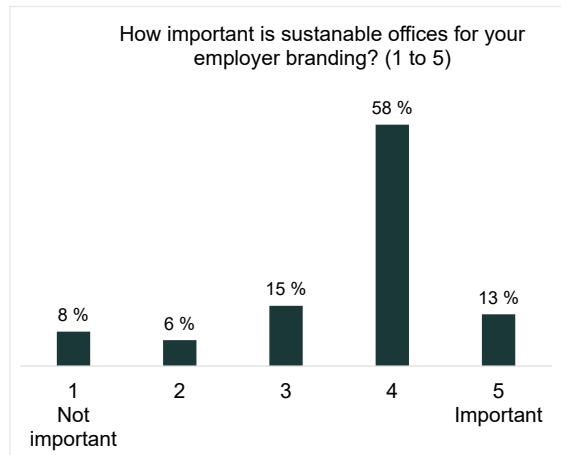
However, the group of companies which are actively seeking sustainable buildings and are willing to pay for it, only make up a small part of the market. They are predominantly large companies with a high degree of ESG maturity which will often have set themselves clear sustainability targets. Most of them are obliged to follow certain rules, either because they are large listed Norwegian companies or because they are even larger international companies with regional representation in Norway. JLL’s international survey paints a more positive picture.

Figure 7: Willingness to pay for green leases globally seems higher than in Norway (JLL)



The consultancy and accounting firm EY is one good example. The company aims to achieve “net zero” including offsets by 2025. Offices and travel are its two largest emission sources. EY has signed leases for the mass timber building SporX in Drammen and for Powerhouse Porsgrunn, and it is actively searching for its next sustainable building in the areas where it operates. This strategy is important for the company’s goals and for its recruitment. Our surveys have found that it is especially reputation and recruitment that are driving the companies’ sustainability ambitions.

Figure 8: Sustainable offices and employer branding



The largest companies aside, demand for eco-friendly buildings is relatively low. Our lettings agents are finding that the rental market still considers green properties as a “nice-to-have”,

once the location, standard and price are satisfactory. We do see environmental factors sway a decision to move, but in these cases the final candidates were close to identical on all other parameters. Sustainability can sway decisions even today.

Widespread demand for sustainable promises will come, as we are seeing in other big cities. However, it is unlikely to materialise until tenants begin to face pressure from their customers or from regulation. As things stand, it can be difficult for tenants to fully understand what is actually required. The introduction of the EU taxonomy has already been postponed, and its scope remains unclear to many companies. 48 per cent of tenants in our survey do not know whether they will be affected by the taxonomy.

## Conclusion

The banks are increasingly likely to offer advantageous terms and are keen to lend more to green investments. Building owners and property developers have high ambitions for their green investments. According to our analyses, these ambitions are largely driven by the belief that the rental market will begin to demand green properties. That demand is still relatively limited, according to our findings. Tenants have relatively high ambitions, but only a few are putting their money where their mouth is at present. In the coming years we are likely to see more examples of green buildings with environmentally conscious tenants, although demand in the mass market will probably only materialise once tenants are faced with concrete, statutory environmental rules.

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