# VALUE PROPOSITION DRAWS INVESTORS TO ESG

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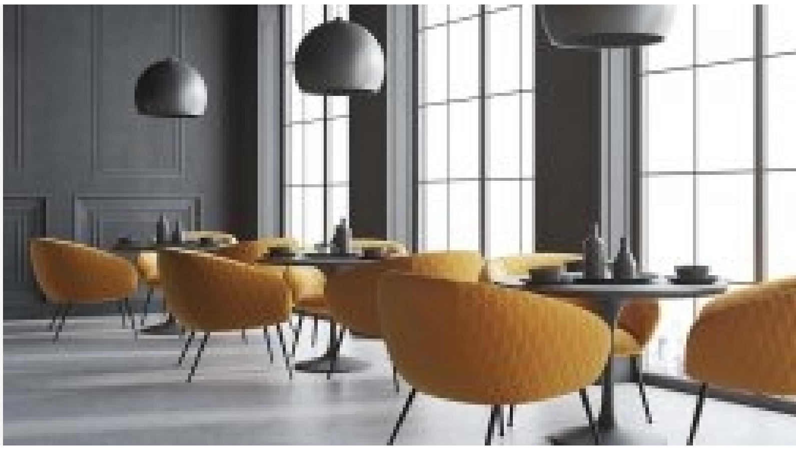
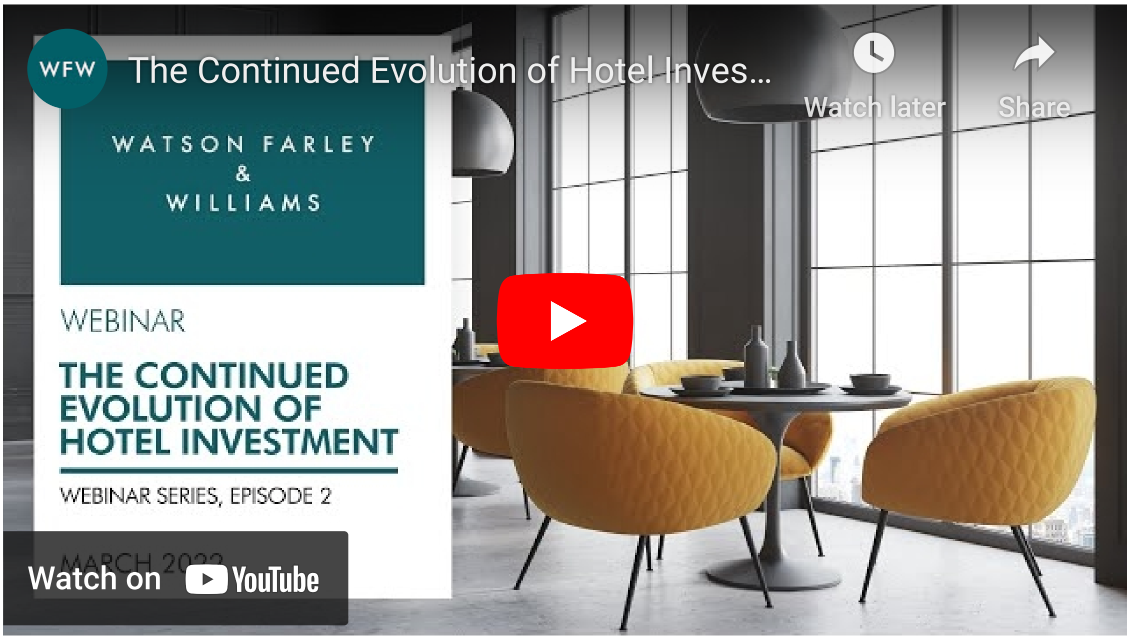


**Investors are taking the opportunity to address ESG compliance ahead of upcoming legislation, motivated by premiums on the value of qualifying assets.**

> "The risk of stranded assets is real. Owners and investors need to have a plan for upgrading and bringing existing hotel stock into line with not just current but anticipated standards..."

Attendees of the 'ESG: From Hope to Happening' webinar, hosted by Watson Farley & Williams ("WFW"), heard that owners and investors are driving change and helping to avoid the threat of assets being stranded by the cost of meeting carbon targets.



Dan Voellm, CEO & Founder at AP Hospitality Advisors, said: “The cost of having an ecologically-obsolete asset varies by region but if we assume inflation increase and rising energy costs plus the cost of carbon credits to offset your consumption, the cost of a stranded asset by 2050 (present value) is around AU$50m. This would have to be taken off the value of the property. Under net zero carbon goals, there are certain initiatives that the hotel industry needs to meet to achieve them by 2050. It’s no joke, the targets are around 95% reduction from 2020 to 2050. That is significant and everybody needs to pay attention because, if you go above the pathway, there is legislation that will penalise you”.

Theodor Kubak, Managing Partner at Arbireo Capital, warned: “The risk of a stranded asset is very real following the implementation of the Sustainable Finance Disclosure Regulation (SFDR) which imposes mandatory ESG disclosure obligations for asset managers and other financial markets participants with substantive provisions of the regulation effective from 10 March 2021”.

There is not only the risk of an asset under water, but also of an impact on financing according to Mr Kubak: “ESG will dominate discussions in the capital markets as well as the finance markets. There will simply be no capital flow if developers, in partnership with brands, aren’t taking care that the requirements set out in the SFDR are specifically met. There are such stringent criteria in place. If any of the funds fail to meet them there is a very real risk that they will be investigated. There is an example right now of a German bank being investigated in the USA for greenwashing”.

WFW London Real Estate Partner Richard Hughes agreed, commenting: “There is a very real connection between stranded assets, credit risks and how you mitigate that through pricing to encourage and incentivise improving current stock”.

Mr Kubak also pointed to the relative ease with which new builds could be constructed to meet carbon targets but cautioned that more than 80% of existing hotel stock faced a risk of being stranded.

Sabine Schaffer, Managing Partner & Co-CEO (Europe) of Pro-invest Group, which successfully renovated a 100-year old hotel, said: “Renovating was not an easy exercise, but I think the advantage we had was having in-house architects and in-house product development managers. Having done a number of conversions before, we have a number of ESG initiatives where we have a good idea of what they are going to cost and the effect of these on the ROI. We found ways of making it work – putting in solar energy, making use of the kinetic energy produced by the lifts, installing carpets made from recycled material – so that over time, and with expertise, we can deliver a product that is going to be as good as it gets when it comes to ESG whilst still keeping the IRR target in mind”.

**"Alignment of interests from developers and suppliers to operators and owners is key to meeting ESG targets."**

Key to an effective hotel operation is alignment across the property, from development to operation, said Ms Schaffer. She added that, being ahead of requirements also helped to secure funding, commenting: “You are more attractive as an entity to funders if you are seen to be taking responsibility”.

Carbon targets vary around the world, creating issues for the global hotel community in terms of deciding which recommendations to follow. Matt Critchlow, Head of France at ClimatePartner, said: "The ecological obsolete threat is a huge stick in the carrot and stick metaphor. Across the board we're seeing pressure from finance, investment and legislation but also pressure from the market. In order to set a very broad but pragmatic and operational roadmap we need to join up the top down forces, whether that be from the COP 26 declarations, from finance, and from investment, with the bottom up initiatives from operators, suppliers and consumers; and then we need to establish boundaries. Avoiding or reducing emissions by compensation or carbon credits alone is not advised – it is not a solution in itself".

The sector has some way to go on finding a cohesive plan, said Mr Kubak: "At HAMA Europe, we have been trying to assist in identifying and harmonising standards. However, there are so many initiatives out there that it has been very, very difficult to identify one. Everyone is striving to participate in the funding made available by the EU for the repositioning of existing assets. But there is no body which has set out the regulations, country by country. Despite advances being made in some territories, it's very fragmented and difficult at this time".

There was, however, optimism among the panel that the investment and climate upside would drive positive change, Mr Kubak concluding: "The real question we need to ask isn't who bears the cost, but who bears the benefit?"

## KEY MESSAGES FROM THE WFW HOTELS & HOSPITALITY TEAM

- The risk of stranded assets is real. Owners and investors need to have a plan for upgrading and bringing existing hotel stock into line with not just current but anticipated standards, as well as be able to demonstrate the deliverability and sustainability of those plans to lenders and equity investors;
- Lenders view ESG as part of their overall credit risk and it is becoming a driver for pricing in the same way as leverage and debt service multiples. Margin ratchets tied to ESG criteria/carbon reduction will be important in encouraging and incentivising improvements to existing stock;
- Harmonisation of disclosure, reporting and standards across different market participants (for example, asset managers may have different reporting and disclosure requirements to owners and lenders) and jurisdictions (for example, the cost of offsetting carbon emissions varies from country to county) is key to developing efficient reporting;
- Comparisons between investors, owners, lenders and even assets may be meaningless, even with harmonisation of disclosure, reporting and standards, with the only meaningful comparison being between the value or carbon performance of an asset before and after the implementation of ESG initiatives; and
- Alignment of interests from developers and suppliers to operators and owners is key to meeting ESG targets.

For further reading on calculating the value at risk for stranded hotel assets, read Mr Voellm's **here**.

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