ESG Materiality Map
Real Estate

July 20, 2022

Climate transition and physical climate risks are the most material factors from stakeholder and credit perspectives. Customer health and safety and access and affordability are examples of factors currently more material for stakeholders than credit.

This report does not constitute a rating action
ESG Materiality Map
Real Estate

In line with the research report “Materiality Mapping: Providing Insights Into The Relative Materiality Of ESG Factors,” published on May 18, 2022, S&P Global Ratings is publishing research on the ESG materiality map for the real estate operator sector. We provide an illustration of our current view of the relative materiality of certain environmental and social (E&S) factors, from both the stakeholder and credit perspectives, for the sector. The materiality map does not represent any new analytical approach to the treatment of E&S factors in our credit ratings. See our ESG criteria for more information on how we incorporate the impact of ESG credit factors into our credit ratings analysis.

Real Estate Sector

In the real estate sector, we focused on companies that majority own a portfolio of stabilized real estate and derive a substantial majority of EBITDA from property rents. This includes companies that are legally organized as Real Estate Investment Trusts (REITs as well as non-REIT operating companies). The portfolio of companies in the industry can include a wide range of property types, such as residential, retail, office, health care, industrial, and hotel properties. We exclude specialty REITs, which are organized as REITs for tax or funding purposes but operate outside the traditional property sectors. For example, we exclude forest product REITs, cell tower REITs, and prison REITs.

Key Takeaways

- Climate transition risks are highly material for stakeholders and credit. The sector significantly contributes to GHG emissions and faces mounting pressure from regulators and tenants to improve properties’ energy efficiency. For credit, incremental investments can require significant capital outlays, potentially reduce the risk of obsolescence or in some markets attract premium rates.

- Physical climate risks can be highly material depending on location, particularly for stakeholders given risks of property damage that can adversely affect tenant’s health and safety. For credit, physical climate risks could also put pressure on tenant safety and stability and operator cash flows, particularly in more exposed geographies. Insurance may also become more challenging or costly to access in the future.

- Community impacts and access and affordability tend to be more material for stakeholders, particularly in the residential sector where affordability and gentrification can alter the social fabric of communities and people’s livelihoods. These issues have had limited impact on credit quality so far but may arise notably from regulatory pressure limiting rent growth, particularly in residential markets.

See materiality map on the following page.
ESG Materiality Map for the Real Estate Sector

The materiality map provides an illustration at a point in time, of our findings on the relative materiality of certain environmental and social (E&S) factors, from both the stakeholder and credit perspectives, for the sector. It does not represent any new analytical approach to the treatment of E&S factors in our credit ratings. See our ESG Criteria for more information on how we incorporate the impact of ESG credit factors into our credit ratings analysis. Source: S&P Global Ratings.

How To Read The ESG Materiality Map

The stakeholder materiality (Y axis) reflects our assessment of the relative level of impacts and dependencies of the sector on the environment, society, and economy.

The credit materiality (X axis) reflects our assessment of the relative level of potential and actual credit impact for the sector. The credit implications for the factors positioned on the left side to the middle of the X-axis would be more limited and absorbable. On the right side, there is higher potential for these implications to be more disruptive. We assess credit implications for an entity based on its individual characteristics.

Assessing E&S factors’ materiality: We consider both the likelihood of the impact from a given factor, as well as the magnitude of the impact. The materiality of the factors varies depending on the perspective (stakeholder or credit) as well as the evolving and dynamic interactions between these two dimensions.

The main areas of the map:

- The upper-right quadrant displays the most material, on a relative basis, E&S factors identified for the sector from both a stakeholder and credit perspective.
- The upper-left quadrant presents factors that are more material from a stakeholder than credit perspective. These factors have the potential to become more material from a credit perspective.
- The bottom-left quadrant shows factors that are less material for both stakeholders and credit. Their materiality may evolve over time and this dynamic may not be linear.
Examples Of Material Factors

Below we provide the rationale of some of the material factors to illustrate the above findings.

Climate transition risk

Climate transition risks are highly material for both stakeholders and credit. Increased energy use in buildings has been a major contributor to climate change, representing around a third of global GHG emissions on a final-energy-use basis according to the IEA. This leaves the sector highly susceptible to the growing public, political, legal, and regulatory pressure to accelerate climate goals. For building operators and their tenants, this may mean higher energy bills as power prices rise, and higher capital expenditures as upgrades are required to accommodate the energy transition and meet more stringent regulatory standards on efficiency or performance. For stakeholders, rising energy costs could affect household purchasing power and the competitive strengths of commercial and industrial properties, although regulatory responses vary by region. For credit, incremental climate-related investments can require significant capital outlays but will potentially reduce the risk of obsolescence due to changes in regulation or tenant’s own climate goals. In addition, portfolios with a greater proportion of assets with low-carbon credentials may achieve higher cost efficiencies or attract premium rents in the longer term, therefore enhancing the assets’ value.

Physical climate risks

The sector’s fixed assets expose operators, depending on location, to physical climate risks, which can have material impacts on stakeholders but have a more moderate bearing on credit. While varying by location, these could include acute risks—such as wildfires, floods, and storms—which are becoming more frequent and severe, as well as chronic risks—such as long-term changes in temperature and precipitation patterns and sea level rise. Acute and chronic risks could cause direct damage to properties and/or place tenant health and safety at risk, as well as require investments to manage potential effects or, in severe cases, relocation of tenants. For the most part, overall stakeholder impact is moderate, since the type, number, and magnitude of these risks varies by region. From a credit perspective, operators with a greater proportion of assets in more highly exposed regions may be subject to sudden operational disruptions if they do not adapt, which may lead to lost income or lower valuation. While most participants have some insurance coverage, which slightly mitigates credit risk, it could become more difficult to secure insurance for the most exposed assets in the future, absent adaptation.

Access and affordability

Access and affordability is material for both stakeholders and credit. From a stakeholder perspective, this factor is especially important for residential tenants where rents can account for a large portion of incomes. Low housing stock and lack of affordable options can severely influence people’s livelihoods, especially vulnerable, low-income populations who can face the threat of homelessness. Lack of accessibility and affordability of commercial properties can also hinder the sustainable growth of local communities. From a credit perspective, these issues have had limited impact on credit quality so far. Yet we believe intensifying regulatory pressure to provide greater access and affordability can affect landlords’ ability to raise rents, particularly for tight residential markets. Reputational risk from aggressive rent increases can also expose REITs to financial impact. These risks have less impact on credit in commercial real estate segments since rents are currently less regulated.
Impact on communities

The impact on communities is highly material for stakeholders but currently has a significantly lower credit materiality. Properties, and by extension their owners, are inherently part of communities in which they operate because they provide an essential service and can shape communities through tenant engagement and community development via jobs and economic growth. For stakeholders, the high materiality of community impacts largely stems from the residential sector where affordable housing and gentrification pressures can alter communities’ social fabric and can be challenging to remediate. Hotels, retail, and offices draw an influx of people into a community, which can be a boon to the local economy but can also affect community dynamics. From a credit perspective, successful property operations and good community relations and foot traffic can support a sustainable level of sales for tenants. But we view this as a less material factor for credit because the impact on community does not directly affect landlords’ financial performance, as this largely depends on tenants and asset quality. The exception is the retail sector, where gathering people into physical stores has become a key focus for landlords seeking to retain retailers (and maintain rents) that are increasingly shrinking their physical square footage and moving online because of secular e-commerce trends.

Customer health and safety

Tenant health and safety has a greater bearing on stakeholders than on credit. Properties can adversely affect tenant health and safety, especially for residential and office properties, since people spend the majority of their time indoors. Although significant risks such as fire or failure of property structural integrity are low-probability events, the impact could be significant, often resulting in serious injury or death, and tend to be more severe in older properties and regions with less stringent safety codes. Customer health and safety factors have had a modest impact on credit quality. The long-term nature of leases as well as tenant and asset diversity, can largely mitigate temporary disruptions in performance in our view, limiting impact on credit.
What is our approach to research on the ESG materiality map?

Referring to the research report “Materiality Mapping: Providing Insights Into The Relative Materiality Of ESG Factors,” published on May 18, 2022, this research is built on the ESG materiality concept that considers ESG issues as material when they could affect stakeholders, potentially leading to material direct or indirect credit impact on entities. It considers that all businesses, through their activities and interactions, impact and depend, directly or indirectly, on stakeholders such as the environment (natural capital), society (human and social capital), and economy (financial capital). Using this ESG materiality concept, S&P Global Ratings has worked toward identifying a common, global, cross-sector set of E&S factors that we believe are material to stakeholders, and either are already, or have the potential to become, credit material for entities. The materiality map we propose provides an illustration at a point in time, of our findings on the relative materiality of those factors, from both the stakeholder and credit perspectives.

How does the sector ESG materiality map relate to credit ratings or ESG evaluations?

The sector materiality map is a visual representation of the factors that we consider impactful to the sector from a stakeholder and credit perspective for the purposes of this research. It does not represent any new analytical approach to the E&S factors in our credit ratings.

The relative materiality of the factors indicated on the materiality maps may inform the E&S Risk Atlas scores and the weights of the E&S factors used in ESG evaluations.

They may also inform our discussions with issuers on those factors’ existing or potential credit materiality.

Related Research

- Materiality Mapping: Providing Insights Into The Relative Materiality Of ESG Factors, May 18, 2022
- Environmental, Social, And Governance Principles In Credit Ratings, Oct. 10, 2021
- ESG Evaluation Analytical Approach, Dec. 15, 2020