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Securing liquidity for ESG transformation

Anticipating ESG's financial challenges



Regulatory requirements as well as changing needs of real estate users require the further development of the strategic orientation of companies. Business decisions should be prepared and managed at an early stage in order to ensure the ability to act, preserve profitability and thus competitiveness. The pressure to align the real estate portfolio with sustainability is increasing. In order to ensure a sustainable business model, the consideration of investments in liquidity planning is essential for the implementation of these megatrends. The determination of additional capital requirements follows directly from this. Which concrete approaches are to be discussed for the operationalization of new requirements, especially for real estate companies? Selected examples are presented in the following article.

Securing the ability to act is necessary

Based on the megatrend ESG (Environmental-Social-Government), companies are confronted with the objective of climate neutrality; this presents them with major challenges. In addition, social aspects must be taken into account in strategic decision-making. The importance of sustainable corporate management is also becoming immensely important. In summary, the implementation of ESG requirements will be a strong focus in the coming years. In the market, there are currently uncertainties about the specific requirements and at the same time the need for companies to implement “green” activities. Due to the lack of definitions of ESG requirements, the current situation can be described as a controversy between pressure to act and ambiguity.

Meeting ESG compliance requires a transformation of business models, including in the real estate industry. In addition to streamlining the portfolio with stranded assets, which can be expected in all asset classes, the industry is sticking to its stability. Compliance with the ESG requirements, some of which have yet to be defined, will be unavoidable, as sustainable investment strategies are expected by the market. In concrete terms, it means that the attractiveness of real estate will in future be measured by the implementation of sustainability requirements. It can be assumed that sustainable assets will be in primary demand in the future.

Shaping the future starts now

The strategic orientation of companies should take into account environmental, social and governance requirements. Investors can minimize their risks by providing the appropriate evidence of ESG suitability of project developments and existing properties. Non-compliance with ESG requirements is expected to have long-term negative effects, such as losses in the value of real estate. Thus, non-ESG-compliant properties could be unattractive, making letting and selling less profitable for owners. After all, market values are positively influenced by the fulfilment of sustainability requirements.

From the perspective of banks, there will be clear preferences regarding financing decisions. “Green companies” that take ESG requirements into account will be able to conclude their (follow-up) financing more easily and, above all, more cheaply. There is currently no binding timeframe for the introduction of all ESG requirements, but it is only a matter of time. The sooner the companies deal with the individual and concrete approaches and thus create transparency, the more likely it is that the existing and expected requirements will be implemented in a timely manner.

It is an opportunity for companies to position themselves clearly at an early stage and thus differentiate themselves from their competitors, even if the requirements for fulfilling ESG conformity have not yet been conclusively clarified. The pressure to act to meet ESG requirements will increase as time progresses. In addition, the capital market will increasingly anticipate that sustainability conformity is of particular importance. It can be assumed that companies that do not comply with ESG will be excluded from the economy in the short to medium term. The early preparation of future business decisions and their management already requires the active examination of current megatrends.

The hurdles ahead are complex and diverse

Even before the pandemic, there were signs of structural change in the real economy. With a time lag, this is transferred to the real estate industry.

Changing needs require adapted structures. It is clear that structural change has been further accelerated by the pandemic. The pandemic acted as a kind of catalyst and currently requires structural adjustments in the strategic direction of companies.

In the media, the topic of ESG is more present than ever. The aim of this article is to summarize concrete fields of action and possible approaches for the operationalization of ESG in the real estate industry. It should be noted that the following approaches provide a basis for discussion. A blanket implementation strategy for all companies should be avoided, as each company must be considered individually and requires a tailor-made implementation strategy. It is particularly important to answer the following questions:

1 — How can the, partially still vague, ESG requirements be quantified and integrated into corporate planning? And what liquidity requirements result from this?

2 — What are the reasons for the developing declines in demand, for example in the office and retail asset classes?

3 — How are the needs of real estate users developing against the background of demographic development?

In the following, fields of action and possible approaches for the operationalization of previously known ESG requirements are presented.

Approaches to operationalize individual ESG fields of action

Peter Drucker declared at the time: "We cannot predict the future, but we can shape it together!" With this in mind, it is important to analyse jointly and at an early stage what room for manoeuvre exists and how it can be exploited.

"E" as in Entry into climate protection and circular economy

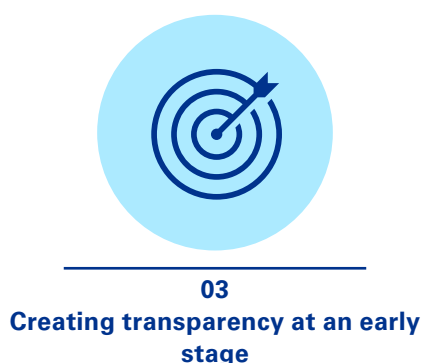
If we first look at the challenge of sustainability from the point of view of the environment, we encounter concepts such as climate change, scarcity of resources and water and air pollution. Selected fields of action are, for example, the implementation of measures in the field of

Illustration 01:

Top-5 reasons for early awareness and the need for anticipatory action

01
Pressure to act and ambiguity

02
Losses in value possible



05
Transformation vs. Consistency

04
Sustainable investment strategies are expected

Source: KPMG in Germany, 2022

renewable energies, water and waste management and also the creation of “green buildings”. In concrete terms, companies can, for example, work on developing their sustainable energy management. This would mean increasingly using solar energy, wind energy and biomass to generate/purchase energy for existing properties. Already during the planning of project developments, such approaches should be analysed for their implementation. The complex but high-potential topic of water and waste management also starts in the early phase of project development, for example in the monitoring of compliance with specifications in the use of building materials according to DIN regulations. With regard to the sustainable management of existing properties, the implementation of “green leases” in the sense of sustainable real estate use can be cited. The tenant should be encouraged to use the property as sustainably as possible and the landlord to manage the property as sustainably as possible.

“S” as in social housing and urban renewal

If we consider the challenge of sustainability from a social point of view, terms around the topic of demographic change and social justice are very present. Behind these topics are concrete fields of action in order to approach a sustainability-compliant structure both in the context of project developments and in connection with existing properties. The field of action well-being and safety includes, among other things, smart fire protection systems, but also security systems to increase the attractiveness of real estate.

Against the background of demographic development, the demand of older people for housing will increase. This requires accessibility and ease of use. It is possible that the approach of an asset class combination involving neighbourhood-related services represents an adequate solution for meeting social needs. It can be assumed that sustainability compliance leads to the appreciation of the property as well as to an increase in well-being. As a result, it is to be expected that fluctuation and thus the rental risk will be reduced.

“G” as indispensable basics

The complex topic of sustainable corporate management encompasses many dimensions within a company, but also a wide range of stakeholders whose interests must be taken into account. The development of a corporate social responsibility concept is currently and above all in the future an important basis for the positively associated corporate perception. In addition, processes and structures within the company must be questioned with regard to their use of resources. More often than before, socially and ecologically responsible corporate management and its documentation will come into focus in the future when it comes to assessing sustainable corporate management.

Illustration 02:

ESG-Activities



Source: KPMG in Germany, 2022

Conclusion / Key Facts:

Integrating increasing spending on climate protection and the circular economy into financial planning

In many respects, the aforementioned megatrend ESG leads to the need to further develop the strategic orientation of companies. In the future, there will be increasing pressure for companies to meet these requirements. Both existing developments and project developments are affected. In this context, the planning of concrete measures to achieve sustainability conformity is essential. The implementation of ESG in the real estate industry first requires knowledge of the status quo and the individual derivation of a concrete ESG objective. On this basis, the investment requirements required by the implementation of sustainability can be determined. Due to the long-term nature of the real estate industry, this planning process must be initiated as early as possible.

In the case of existing plans and projects, the previously not so dominant ESG requirements were not known at the time of planning of the properties and their implementation was accordingly not taken into account in the financing and liquidity planning. What should be the next steps in dealing with the topic of ESG?

Meeting sustainability requirements leads to investments that require additional liquidity. In connection with the further development of the strategic orientation, the structured determination of future capital requirements, which are at least partially disregarded by ESG in ongoing financing, is indispensable. Early awareness of the upcoming megatrends (e.g., ESG, decline in demand, demographic development) and their effects make it possible to identify concrete options for action in good time and to use strategic scope for action. Possible options for action can thus already be transferred into a quantitative model for the simulation of possible alternative decisions in the form of scenarios. Only then can liquidity be secured within the framework of a financing negotiation on a resilient and sustainable basis. The consideration of individual megatrends in the strategic orientation thus offers the possibility of reliably deriving the required liquidity requirements for different financing alternatives or negotiations. As a result, the question can be answered whether the available/procurable liquidity is sufficient to be able to carry out the transformation associated with the megatrends and the corresponding investments with a given return expectation or whether further strategic adjustments are necessary.

Illustration 03:

Approach to secure the Liquidity

Plan of measures

01



Liquidity planning

02



Capital requirements and bank negotiations to secure liquidity

03

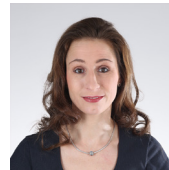


Source: KPMG in Germany, 2022



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