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OFFICE OF THE COMPTROLLER



Memo

SUBJECT: Grounds for a **Yes** vote on Boston Properties shareholder resolution concerning sustainability and climate change

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RESOLVED: *Shareholders request that the Board of Directors prepare a sustainability report describing corporate strategies to reduce greenhouse gas emissions and addressing other environmental and social impacts such as water and waste management, and employee and community relations. The report, prepared at reasonable cost and omitting proprietary information, should be published by December 2009.*

Rationale for YES vote:

1. **Boston Properties' shareholders bear significant financial and competitive risks** if Boston Properties does not develop and report on clear policies and programs that address the impacts of its operations on society and the environment.
2. **Sustainability reporting is a key element of real estate business success.**
3. **Boston Properties lags behind its peers in** adequately disclosing its sustainability policies and practices.

BOSTON PROPERTIES' SHAREHOLDERS BEAR SIGNIFICANT FINANCIAL AND COMPETITIVE RISKS

Boston Properties needs to develop and report on clear policies and programs that address the impacts of its operations on society and the environment. Investors are beginning to realize that a company's long-term viability cannot be captured, as previously thought, through traditional reporting and accounting alone. If the current market crisis has shown us anything, it is that there are significant "intangibles" affecting company performance. Up to 75% of a company's value is based on intangibles,¹ which can include environmental, social, and governance (ESG) issues and risks. Sustainability reporting is particularly important in a field such as real estate that has significant impacts on society and the environment – and thus such vulnerability to changing regulations and customer preferences.

¹ Kaplan R. S. & Norton D. P., 2004, *Strategy Maps: Converting intangible assets into tangible outcomes*, Harvard Business School Press: Boston, pp.3-4.



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In fact many ESG issues, such energy cost management, are simply material financial issues. A 2005 article in the *International Real Estate Review* noted that “a new view is emerging, based on a growing awareness among real estate professionals that various social and environmental issues can have significant material consequences for their investment portfolios. Shifting consumer behavior, worsening environmental hazards, tougher government regulations, expanding legal liabilities, increasingly expensive resource and material inputs, and greater pressure from affected stakeholders are all converging to make it both financially risky to ignore social, environmental, and governance concerns and financially beneficial to address them in the process of real estate investing.”²

Strong disclosure will improve Boston Properties’ ability to manage stakeholders’ interests and minimize financial and competitive risks such as those quoted above. For instance, the Department of Energy’s *2008 Buildings Energy Data Book* reports that U.S. buildings are responsible for approximately 40% of U.S. primary energy consumption, approximately 70% of electricity consumption, and about 38% of U.S. CO₂ emissions.³ These figures in and of themselves are concerning due to the volatile costs of traditional energy sources. But local, state, and federal governments are considering or implementing regulations to reduce greenhouse gas emissions and improve buildings’ energy efficiency, resulting in significant risks and opportunities for the real estate sector. To consider just one prominent example of a trend towards making buildings (and requiring buildings to be) more efficient, the American Recovery and Reinvestment Act of 2009 (the stimulus bill) included:

- \$6.3 billion for energy efficiency and conservation grants to state and local governments;
- \$5 billion for the Weatherization Assistance Program to weatherize low-income homes;
- \$4.5 billion to improve efficiency at federal buildings;
- \$4 billion for local public housing agencies to address energy efficiency in aging buildings;
- \$250 million to increase energy efficiency in federally assisted housing; and
- perhaps most importantly for the real estate sector, a provision that conditions a state’s receipt of additional State Energy Program funding on the Governor assuring the Secretary of Energy in writing that the state (or local) government will implement residential and commercial building codes that meet or exceed efficiency standards, such that within 8 years at least 90% of new and renovated residential and commercial building space is in compliance.

The building sector also must consider climate risks. While the housing and building sectors are not the primary target of climate legislation, such legislation will have an impact on commercial property owners concerned about electricity costs. The physical impacts of climate change could also have significant impacts on the sector, with sea level rise threatening coastal property, with

² Pivo and McNamara. “Responsible Property Investing.” *International Real Estate Review*. 2005. V8, No.1, pp. 128-143. [http://cbeweb-1.fullerton.edu/finance/irer/papers/past/vol8_pdf/Pivo-Mcnamara\(128-143\).pdf](http://cbeweb-1.fullerton.edu/finance/irer/papers/past/vol8_pdf/Pivo-Mcnamara(128-143).pdf)

³ U.S. Department of Energy, *2008 Buildings Energy Data Book*, Chapter 1, <http://buildingsdatabook.eren.doe.gov/>



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more frequent severe weather events raising questions about building resiliency, and with intensified droughts raising concerns about the sector's water use.

At the same time, of course, addressing ESG issues such as climate change also represents an opportunity for Boston Properties. The green real estate market, for instance, has been growing exponentially and is a rare bright spot in the current real estate market. A 2005 survey by McGraw-Hill of U.S. architects, engineers, and contractors highlighted the financial benefits of sustainable real estate over the life of the building, including an average expected decrease in operating costs of between 8% and 9%, an average expected increase in building value of around 7.5%, an average expected increase in occupancy rate of 3.5%, an average expected increase in rental yields of 3%, and an average expected increase in ROI of 6.6%.⁴ McGraw-Hill Construction, in its *2009 Green Outlook*, noted that the depressed market makes it that much more important for the industry to seize the opportunity created by the demand for more sustainable buildings. McGraw-Hill estimates the current green building market to be about \$36-49 billion today and projects that it will more than double to \$96-140 billion by 2013.⁵

SUSTAINABILITY REPORTING IS A KEY ELEMENT OF REAL ESTATE BUSINESS SUCCESS

Many investors believe that companies that are good employers, environmental stewards, and corporate citizens are more likely to generate stronger financial returns. Mainstream financial companies are also increasingly recognizing the links between sustainability performance and shareholder value. According to research consultant Innovest, major investment firms including ABN-AMRO, Schroder, T. Rowe Price, and Legg Mason subscribe to information on companies' social and environmental practices to help make investment decisions.

Sustainability disclosure can help improve operational efficiencies and profit margins. Disclosure of progress on key performance indicators (e.g., energy use, recycling, waste reduction, etc.) can help demonstrate quality management to investors – and often real cost savings.⁶ With regards to workplace safety, improved sustainability disclosure can lead to indirect bottom-line benefits. Better employee training and increased employee awareness of health and safety issues can lead to fewer errors and help drive down occupational injuries. This can provide real cost savings in terms of insurance and workers' compensation. Higher employee retention often means lower recruiting costs and lower initial training cost associated with new hires. Furthermore, the sustainability reporting process itself adds value to companies because it helps management determine which indicators are most material to their business and which should get prioritized.

⁴ Ivo Knoepfel and Gordon Hagart. "Seeking rewards in sustainable real estate." *Global Pensions*. Jan. 21, 2008. http://globalpensions.com/showPage.html?page=gp_display_feature&tempPageId=686541

⁵ McGraw-Hill Construction, *2009 Green Outlook: Trends Driving Change*, http://www.construction.com/market_research/reports/GreenOutlook.asp

⁶ Earthwatch Institute, the World Conservation Union, World Business Council for Sustainable Development and World Resources Institute, *Ecosystem Challenges and Business Implication*, 2006,



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In a 2006 meeting of professionals from the real estate and investment sectors, several attendees made the point that socially and environmentally responsible property investment “has the potential to improve returns by utilizing property design or management strategies that both add value and produce social or environmental returns. . . . And responsible property development can lead to lower operating costs and vacancy rates, faster and more reliable construction by using skilled union labor, higher rents and capital appreciation, more streamlined permitting and public incentives, greater customer loyalty, better reputations for owners, investors, and developers, and fewer long term risks.”⁷

BOSTON PROPERTIES LAGS BEHIND ITS PEERS IN ADEQUATELY DISCLOSING ITS SUSTAINABILITY POLICIES AND PRACTICES

An increasing number of companies worldwide have been developing sustainability reports, which not only improve corporate transparency on issues such as environmental, social, and governance risks, but also allow the company and key external stakeholders to improve the company’s overall financial health with respect to these material ESG risks.

As more and more corporate leaders recognize that business in the 21st century is going to be vastly different, they have turned to producing record numbers of formal sustainability reports that help meet the needs of various stakeholders, including investors and customers. There is a steady increase in global sustainability reporting. Over 2,300 companies issued reports on sustainability issues in 2006, according to the Corporate Registrar, including over half of the global Fortune 250.⁸ For the largest 10% of companies in the DJ STOXX Global 1,800 index, this figure jumps to 82%.⁹

Boston Properties, one of the largest office REITs by market capitalization, has not issued a sustainability report. The company does recognize environmental sustainability within its annual report and 10-K filings, but does so in an incomplete way, and omits mention of key social issues, such as labor practices. While some laudable efforts at energy and natural resource conservation are described, a comprehensive plan is not outlined nor are relevant goals provided. The reporting also fails to make any mention of climate risk and the degree to which climate change and other ESG-related factors might exacerbate other risks and impact financial sustainability. Further, the company has not responded to the Carbon Disclosure Project’s fifth or sixth surveys.

Other industry competitors, in contrast, have gone much further than Boston Properties in their sustainability disclosure. For instance, Simon Property Group, Vornado, CB Richard Ellis, Centex, and KB Home have already responded to CDP. Real estate companies such as CB Richard Ellis Group, KB Home, and ProLogis have issued sustainability reports. For example,

⁷ “Conference Report: Real Estate and Socially Responsible Investment: New Products, New Investments, New Value.” 2006. p.6. www.responsibleproperty.net/assets/files/tucson_conference_report_final.pdf

⁸ KPMG, International Survey of Corporate Responsibility Reporting, 2005.

⁹ Social Investment Research Analyst Network, “Companies Increasingly Report on Sustainability Issues,” November 15, 2007. http://www.siran.org/pdfs/SIF_SIRAN_release_11-09-07.pdf



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CB Richard Ellis’s GRI-based *2007 Corporate Responsibility Report* covers the company’s results and goals with respect to governance, ethics and compliance, environmental stewardship, workplace, health and safety, and philanthropy. Even within just the environmental stewardship section, CB Richard Ellis lays out its goal of achieving carbon neutrality by 2010, describes some of the concrete internal actions it has taken and the results it has achieved, mentions areas for improvement, and notes the services CB Richard Ellis is offering its clients as they pursue energy savings and sustainable environmental performance¹⁰

| | Sustainability Report | CDP Response |
|-----------------------------|-----------------------|--------------|
| Boston Properties | x | x |
| CB Richard Ellis | ✓ | ✓ |
| Centex | ✓ | ✓ |
| KB Home | ✓ | ✓ |
| ProLogis | ✓ | ✓ |
| Simon Property Group | x | ✓ |
| Vornado | x | ✓ |

Boston Properties’ investors need to see a clear plan for ensuring viability and competitiveness going forward as regulatory and consumer demands for sustainability increase.

¹⁰ CB Richard Ellis, “The Universal Values of CBRE: 2007 Corporate Responsibility Report.” http://www.cbre.com/NR/rdonlyres/BA70BED7-1D66-4827-BD37-8B2DB6471762/0/Corporate_Responsibility_Report_FINAL.pdf