Sustainability Due Diligence: LEED® as the Evolving National Standard

This article examines current trends in the finance and real estate industries related to due diligence and sustainability. According to the authors of the article, the emergence of the U.S. Green Building Council's Leadership in Energy and Environmental Design rating system, together with the establishment and backing of the Carbon Principles by some of the world's leading financial institutions, provide the emerging sustainability due diligence industry with a well-grounded starting point to begin addressing the demands and embracing the opportunities presented by the sustainable real estate revolution.

231.2015 Introduction*

Green building and sustainability initiatives are taking hold rapidly throughout the real estate and finance industries. A confluence of events, including rapidly escalating energy costs, the implementation of multi-jurisdictional carbon emission regulations,[1] and decreasing costs associated with green building practices, has provided compelling rationales for the industry to implement long-term policy and procedural changes to identify sustainability-related risks and opportunities that can be uncovered by a thorough sustainability due diligence process.

As the premium costs associated with green building continue to diminish because of increased competitiveness of green building materials in the supply chain and enhanced education among Leadership in Energy and Environmental Design (LEED) accredited professionals, the real estate industry is accelerating its incorporation of green building in both new and, increasingly, existing buildings. Rapidly escalating energy costs further enhance the return on investment associated with energy-efficient green building activities, which also is hastening the industrywide acceptance of green building practices. Real estate investment trusts and institutional investors are revising their "Class A" building definitions to include, and increasingly require, those with LEED certification as once-anecdotal evidence that such a designation enhances the marketability and value of their properties becomes more common. States now routinely are including green building requirements in regulations pertaining to the acquisition and leasing of commercial properties. Meanwhile, the General Services Administration is developing regulatory protocols to carry out the federal government's green leasing mandate that will become effective in 2010.[2]

This article provides an update of the underlying demand drivers in the commercial marketplace and a focus on the emerging LEED standards that will provide the framework to facilitate rapid and efficient incorporation of green building practices throughout the real estate and finance industries.

(a) Sustainability v. Environmental Risk

In contrast to traditional environmental risk due diligence, incorporating sustainability factors into the real estate assessment and finance process often can uncover readily available economic incentives and cost-saving measures that can enhance the value of the asset being investigated. Given the significant impact buildings have on the overall consumption of energy and resultant greenhouse gas (GHG) emissions in the United States, they increasingly will become the target of energy efficiency and regulatory efforts as well as a myriad of economic incentives to motivate sustainability behavior among property owners and tenants. The statistical basis for this focus on buildings is compelling. The Environmental Protection Agency estimates energy consumption from buildings accounts for 18 percent to 20 percent of all domestic GHG emissions. The Department of Energy estimates buildings account for 39 percent of total annual energy consumption in the United States, and the U.S. Green Building Council estimates buildings account for 70 percent of U.S. electricity consumption.[3]

To address these challenges in a timely and consensus-based approach, the real estate industry and financial institutions now must coalesce around a set

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[1] *See* American Bar Association, Global Climate Change and U.S. Law (Michael B. Gerrard ed., 2007) for a comprehensive overview of the Kyoto Protocol as well as similar programs in the United States at the national, regional, and state level.

[2] *See* Energy Independence and Security Act (P.L. 110-140) Title IV, Section 435 enacted December 2007.

[3] *See* US Energy Information Administration, *Commercial Buildings Energy Consumption Survey*, available on the Web at http://www.eia.doe.gov, and analysis contained in *Current Critical Issues in Environmental Law; Green Buildings and Sustainable Development.* Mark J. Bennett, J. Cullen Howe, James Newman. LexisNexis, June 2008. More information is available on the Web at http://bookstore.lexis.com/bookstore/product/71521.html.

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of sustainability due diligence standards and requisite practices to govern the evolution of this process in the near term. Competitive market influences, including insurance providers, lenders, and tenants who increasingly recognize the positive economic value of green buildings, are accelerating this evolution and providing further amplification of an immediate call to action. Financial institutions are responding to this trend quickly as they establish sustainability departments, often recruiting talent from traditional environmental risk management areas of their organizations.

(b) Lessons Learned From the European Union

From a regulatory perspective, the recent implementation in the European Union of the Energy Performance of Buildings Directive 2002[4] in support of the Kyoto Principles, which includes the compulsory provision of Energy Performance Certificates as a pre-condition to the sale or leasing of certain types of commercial properties, has lead to significant and unexpected transaction bottlenecks. The EU engineering and real estate services communities are responding rapidly to these marketplace challenges to assist with compliance with these mandates. Accordingly, the EU experience presents a learning experience for U.S. real estate industry professionals to prepare for similar sustainable real estate management regulations, which are slated for introduction by the state of California in 2010[5] and likely more broadly throughout the United States shortly thereafter. Futhermore, the 2008 U.S. presidential election likely will mark a watershed event for the advent of a strict set of U.S. climate change regulations, including stepped up enforcement of disclosure requirements by the Securities and Exchange Commission. These SEC disclosure requirements could impact significantly registered companies that have material direct or indirect energy consumption and emissions associated with their real estate assets and operations.[6]

(c) LEED-ing the Way With the Carbon Principles

As the need for sustainability due diligence among real estate owners and financial institutions expands, a focus has evolved regarding the standards that will govern this process as well as the professionals who will deliver such services. The environmental professional community (estimated to be greater than 10,000) is well-positioned to take on this challenge. Several resources now are available to assist these professionals with defining the scope of work to satisfy sustainability due diligence requirements. Chief among these resources are the Leadership in Energy and Environmental Design (LEED) rating system[7] and the Carbon Principles.[8] As outlined below, these two resources provide the emerging sustainability due diligence industry with a well-grounded starting point to begin addressing the demands and embracing the opportunities presented by the sustainable real estate revolution.

(d) LEED as the De Facto Standard

The LEED rating system, established by the U.S. Green Building Council (USGBC),[9] has become the prevailing and arguably de facto marketplace standard for conducting sustainability due diligence in both a portfolio management and transactional setting. It is becoming codified as a brand name standard at the national, state, and local levels through incorporation into energy efficiency and sustainability regulations, including building code mandates as well as economic incentives for integrating green building practices. These incentives, which typically include accelerated permitting, density bonuses, low-interest loans, and property tax rebates, among other tools, already are being replaced in some local regulations by LEED-related mandates.[10] Illustrative among them are Houston and Los Angeles regulations that recently have been adopted or further enhanced to include LEED mandates in conjunction with certain types of construction and/or renovation activities.

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[4] Directive 2002/91/EC of the European Parliament on the energy performance of buildings as reprinted in Official Journal of the European Communities 4.1.2003 L 1/65. This document is available on the Web at http://www.buildingsplatform.org/cms/index.php?id=7&no_cache=1.

[5] *See* California Assembly Bill 1103 signed into law by Gov. Arnold Schwarzenegger (R) Oct. 12, 2007.

[6] *See Disclosure of Climate Change Risks and Opportunities*, Jeffrey A. Smith, The Review of Securities & Commodities Regulation, Vol. 41, No. 1. (1/2/08).

[7] *See* Green Building Council Web site at http://www.usgbc.org/DisplayPage.aspx?CMSPageID=222.

[8] *See* http://www.carbonprinciples.org and http://www.citi.com/citigroup/environment/carbprinciples.htm for comment by principal author Matthew Arnold.

[9] USGBC was founded in 1993 and comprises more than 15,000 real estate and building related organizations.

[10] Houston, Texas, Resolution No. 2004-15, subsequently enhanced April 2008, and Los Angeles City Council Resolution, Feb. 15, 2008.

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USGBC has continued to integrate its public policy objectives into the mainstream real estate industry through continuous involvement and dialogue with major trade groups, including the Building Owners and Managers Association, CoreNet Global, Environmental Banker's Association, International Council of Shopping Centers, and National Association of Office and Industrial Properties among others, which are obligated as stakeholders in the process to represent the interests of their constituents as sustainability policies evolve. Reflective of USGBC's responsiveness to this dialogue was a notable announcement made May 19, 2008, in which USGBC released for public comment as its "guiding vision" LEED 2009, also known as LEED Version 3.[11] LEED 2009 focuses on three primary areas, including LEED Rating System updates and revisions, the evolution of the building certification and professional accreditation process, and enhancements to LEED Online (17 EDDG 45, 6/19/08) to bring further efficiency to the entire LEED certification process. The document notes that as of May 8, 2008, more than 3.5 billion square feet of building projects, including more than 10,000 individual projects, have registered to seek LEED certification.[12] Among the many notable provisions in LEED 2009 is the movement toward regionalization in the standards process that will reflect regionalized environmental conditions as opposed to the national "one size fits all" approach contained in the current LEED standards. This will be implemented through a system of developing "regional bonus points," which can be utilized in determining a project's overall potential scoring combinations. For example, water conservation efforts may be designated with regional bonus points in the southwestern United States where water supplies are in shorter supply than the Great Lakes region.

Recent developments suggest LEED is taking hold outside of the United States as global real estate owners seek a uniform international standard against which to manage and benchmark their sustainable real estate programs. As further evidence of LEED's reach, more than 20,000 individuals have achieved the LEED accredited professional designation and are putting their new skills to work throughout the industry.

LEED-EB (Existing Building) is emerging as a particularly important rating system among the many developed by USGBC because it focuses on near-term economic benefits that can be obtained from an existing building. Given the current slowdown in new construction in the commercial real estate industry, such a focus is yielding tangible short-term benefits in terms of increased operating efficiency and resulting cash flows as well as making real estate assets more attractive to tenants and buyers seeking the benefits offered by green buildings. The *LEED for Existing Buildings: Operations & Maintenance Registered Project Checklist*[13] provides a solid baseline information gathering tool and the foundation for identifying capital improvement projects with relatively short (one- to three-year) payback periods. Often this process can result in re-allocating capital improvement budgets toward areas of higher return on investment without increasing the overall investment level across a portfolio. Notably, the focus on basic maintenance and operating procedures, such as conducting routine janitorial service during daylight hours and other simple behavioral changes, can have immediate tangible benefits with no capital investment. Additionally, LEED-EB incorporates EPA's Energy Star rating system,[14] which can provide a useful benchmark in assessing the relative energy efficiency of one building against an entire portfolio or competing buildings in a local market area.

Furthermore, proprietary and sophisticated sustainable real estate management platforms now are emerging, which also will facilitate multidimensional internal and external benchmarking. Such systems typically involve cooperation among users so one user's buildings in a certain asset class and geography can be compared against those owned by all users, providing a further benchmarking metric for a particular building's relative sustainability.

The incorporation of sustainability management into the real estate industry requires a review of current properties held in portfolio, plus active "lifecycle monitoring" of such properties and screening of new properties as they enter the portfolio, to ensure conformance with overall portfolio benchmarking metrics and sustainability policies. Sustainability enhancement projects for a single property typically

[11] *See* USGBC Web site at http://www.usgbc.org/News/PressReleaseDetails.aspx?ID=3701. *See also* (17 EDDG 45, 6/19/08).

[12] *See* USGBC Web site at http://www.usgbc.org/ShowFile.aspx?DocumentID=4121.

[13] *See* USGBC Web site at https://www.usgbc.org/ShowFile.aspx?DocumentID=4093 for the most recent checklist version.

[14] *See* http://www.energystar.gov/ on the Web for more information on the Energy Star program.

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are multiyear projects that must be aligned with long-term capital improvement budgets and also provide assurance such projects reflect best available technologies and building practices. The rapid evolution of green building standards and practices presents a challenge to ensure such standards continually are monitored to avoid "built-in obsolescence" at the completion of a project. Recently, a nascent industry of "LEED auditors" has sprouted in which architects, engineers, environmental professionals, and LEED consultants have begun to offer services enabling a building owner, lender, or tenant to assess the LEED baseline of a building as well as the time, money, and effort involved in achieving varying levels of LEED certification for the property.

(e) The Carbon Principles: The Magna Carta of Sustainability Due Diligence

On February 4, 2008, the Carbon Principles,[15] a collaborative statement of sustainability and requisite due diligence objectives, was released by Citigroup, JP Morgan Chase, and Morgan Stanley. The Carbon Principles provide a well-articulated and thorough policy framework that offer a road map for the broad adoption of sustainability due diligence in the financial institution and real estate industries. The publication of the principles was a threshold event in establishing the lending industry as the "gatekeepers of sustainability due diligence." While the principles are focused on large, upstream power generation facilities, they provide a valuable framework for translation into more routine commercial real estate transactions. Notable in the principles is the collaborative approach taken by three leading financial institutions. Such an approach provides consistency to the borrower community and can minimize potential marketplace disadvantages that one financial institution might face if it undertook such a strategy alone. An important aspect of the principles is its focus on opportunities in the energy-efficiency area that can positively impact operations and thus collateral value. This provides yet another point of contrast with the risk-avoidance focus of traditional environmental due diligence, which often has little or no tangible upside economic benefit. The positive results emanating from a sustainability assessment requested by a lender from a borrower position the lender as a valuable resource to the borrower in identifying efficiencies and potential economic incentives through existing regulations the borrower otherwise might be unaware of.

A summary of the Carbon Principles, as outlined below, provides the commercial real estate and financial institution industries with a road map and policy development discussion framework that can assist in focusing the process of sustainability due diligence. While the Carbon Principles are targeted toward large upstream energy production facilities and were created in a consensus approach with the regulated utilities industry, they encompasses the essential elements of a due diligence approach, which can be applied in commonplace commercial real estate transactions. The principles establish the Enhanced Environmental Diligence Process through the development of five process items.[16] The outline below references each of these items along with an analysis of how this adaptation should be considered by financial institutions in the development of sustainable due diligence policies and procedures.

(1) Process Item 1: Enhanced Environmental Diligence

"The Financial Institution will conduct the Enhanced Diligence Process as outlined in Exhibit I. Such process will be reflective of the specific CO_2 footprint of the project/transaction and the regulatory regime that the Client operates under. As appropriate, a third party consulting firm may perform the Enhanced Diligence Process and provide a written assessment to the Financial Institution."

Exhibit I is a detailed review of the borrower's energy efficiency and greenhouse gas (GHG)-related policies and procedures that could be indicative of an overall level of current exposure as well as the likelihood of future events and new regulations that could affect the collateral value of a secured property or the overall cash flow of the borrower. In an analogous fashion, lending institutions should begin to develop enhanced, industry segment-focused environmental diligence that reflects existing and potential risk factors prevalent in such industries. For example, a loan secured by a heavy industrial manufacturing facility would require a higher level of scrutiny than would a suburban office building or multifamily apartment complex. Lenders should begin identifying their primary industry-based loan portfolio concentrations and draft credit underwriting policies reflective of the unique risks and opportunities associ-

[15] The Carbon Principles are available on the Web at http://carbonprinciples.org.

[16] The Carbon Principles' Enhanced Environmental Diligence Process is available on the Web at http://carbonprinciples.org/documents/Carbon%20Principles%20Diligence%20Final.pdf.

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ated with such real estate assets associated with each industry type. Because many financial institutions themselves are significant owners and tenants of commercial real estate, a portfolio review of their own operating facilities (REO, or real estate owned) can act as a stimulus for focusing the institution on developing sustainability objectives. Often this process identifies near-term economic savings that are useful in educating those not yet familiar with such savings aside from the broader positive environmental impact. With this platform in place, the institution then looks to translate such polices into loan officer training programs. Such programs can prepare front-line loan officers with the necessary understanding and vocabulary to engage borrowers who are becoming increasingly sophisticated in this area. Often such a dialogue can lead to the bank identifying economic incentives in the form of tax credits and grants that can benefit both the borrower and lender.

(2) Process Item 2: Carbon Mitigation Plans

"For a Qualifying Fossil Fuel Generation Plant, the Financial Institution will review the Client's carbon mitigation plans, which include planning, research, experimentation, risk management and investment in carbon mitigation. The level of detail of the plans and the priority of the identified actions should be commensurate with the potential CO_2 impact of the Fossil Fuel Generation. Carbon mitigation plans generally include an examination of the options available to the Client to reduce or offset some portion of the CO_2 emissions of the Qualifying Fossil Fuel Generation Plant and/or the planned, current and future actions by the Client to manage its overall CO_2 footprint. The carbon mitigation plans will help the Financial Institution better understand and assess the Client's strategy toward mitigating the risks posed by carbon limitations."

The impact of a building's CO_2 footprint must be viewed on both a direct and indirect basis. Direct CO_2 emission equivalents are associated with onsite combustion of energy as well as site-specific industrial processes, while indirect emissions are more closely associated with utilization of energy from an offsite third-party utility as well as energy consumed by the building's employees, supply chain, and visitors to the property. The Global Reporting Initiative[17] has been adopted widely as the technical framework for calculating a building's CO_2 footprint for purposes of disclosure to the Carbon Disclosure Project[18] (CDP) and other nongovernmental organizations focused on sustainability matters. The CDP, now in its sixth year, has acted as a surrogate regulator in the current U.S. regulatory vacuum. It is scheduled to be filed in May of each year and has become the goal against which financial institutions implement their annual sustainability programs.

One of the evaluation criteria used by CDP in evaluating a financial institution's sustainability rating is the degree to which it incorporates sustainable factors into the credit evaluation process. In a suburban office building, the source of energy supplying the building and its requisite CO_2 equivalent emission per kilowatt of energy consumed by the building often is a utilized metric in determining such calculations. The incorporation of renewable energy (e.g. biomass, geothermal, solar, wind) into the fuel mix of the utility supplying a particular building will become increasingly important for determining this calculation as building owners and tenants are demanding increasing specificity in this measurement. The output of this calculation can have direct financial consequences in the form of a landlord and/or tenant obligation to purchase CO_2 offsets pursuant to a regulatory cap-and-trade system and/or corporate sustainability policy. More than 29 states have adopted Renewable Portfolio Standards (RPS), which require regulated utilities to evolve their fuel mix for electricity generated to include a certain percentage of renewable resources by a specified date. It is important for real estate owners to monitor evolution of the RPS in their state and the resulting impact these regulations will have on indirect CO_2 generation by specific real estate assets. In essence, the cost of carbon is being viewed as an occupancy cost by tenants responsible for utility expenses. For landlords responsible for utility expenses on gross leases, this increased operating expense has a negative impact on net operating income and thus impacts the value of the real estate asset. Buildings with a lower cost of carbon will be more attractive to tenants and easier to lease. Thus, the cost of carbon impacts asset value for landlords whether or not they are responsible for energy-related expenses.

The RPS movement also creates an opportunity for buildings to include demand management programs that result in decreased consumption of energy as the basis for creating a renewable energy credit, which in several states can be sold to a regu-

[17] *See* http://www.globalreporting.org for access to the Sustainability Reporting Guidelines.

[18] *See* http://www.cdproject.net/index.asp for background on the Carbon Disclosure Project.

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lated entity facing an RPS mandate. Wireless utility meter management systems and associated remote sensing technologies can have a significant impact on the operating efficiency of a particular building. Such technologies actively are being adopted by commercial real estate owners and operators because the paybacks associated with such systems are increasingly attractive and can be funded in part by a variety of economic incentives, often including those offered by local utilities providing service to the buildings that utilize such technologies.

(3) Process Item 3: Independent Assessment

"The Financial Institution will ensure a review of the Client's risk from potential CO_2 costs is undertaken by their in-house experts or a third-party consultant. Additionally, in transactions where demand forecasts from the Client and other constituencies significantly differ, the Financial Institution may—at its discretion—require that a third-party consulting firm review the demand forecasts and render an independent demand forecast to the Financial Institution."

To sustain the scrutiny of stakeholders, including customers, investors, and regulators, sustainability due diligence must be conducted independently by qualified professionals. With the likely incorporation of sustainability as a regulated risk covered by U.S. securities regulations, most of the major financial auditing[19] firms have created sustainability practices poised to review a company's sustainability policies and issue opinions that can be relied upon by all relevant stakeholders. In a real estate setting, an equal level of reliability and transparency is required, given that buyers, insurance companies, lenders, sellers, tenants, and others are relying on the outcome of sustainability due diligence as a basis for decisionmaking relative to certain assets. The environmental due diligence industry has evolved over the past 20 years and is well-positioned to adapt its skills to meet this challenge and provide efficient services to support these burgeoning requirements. Current providers of both Phase I environmental site assessments and property condition assessments (PCA)[20] are well-suited with appropriate additional training to become trusted suppliers in support of this process. It is likely environmental professionals (EPs) and PCA firms will take on this challenge and add sustainability due diligence to their repertoire. The technical backgrounds and building science experience of these groups provide a foundation for the new issues that must be addressed in sustainability due diligence. These include energy assessment and benchmarking, green landscaping design, indoor air quality, lighting assessment, and water conservation and management. Some of these new issues have a natural overlap with conventional due diligence topics. For example, indoor air quality issues include moisture intrusion and mold concerns often included in Phase I ESAs and PCAs. Additionally, the act of tightening the building envelope to improve energy efficiency can have the unwanted consequence of creating moisture intrusion and mold problems in some instances. The demands of well-insulated, tightly sealed structures must be balanced with the need to provide adequate ventilation and avoid condensation problems in a building. EPs and PCA consultants on a regional level already have begun to formulate LEED assessment checklists, procedures, and training programs in response to their clients' requests for such services.

The definition of the term "environmental professional" has been fraught with controversy ever since the term was coined in the early meetings of ASTM committee E-50, which included heated debate whenever the EP definition was considered. In the more recent roundtable "all appropriate inquiries" (AAI)[21] regulatory negotiation sessions and public comment period this continued to be a hot topic. The subject receiving the most comments during the Environmental Protection Agency's 2003-2004 AAI public comment periods was the definition of environmental professional. Some commenters wanted only professional engineers and professional geologists to qualify as EPs. Others wanted various professional registrations to be recognized, including certified hazardous materials managers or registered environmental professionals. Several state professional registration programs were proposed for recognition, including registered environmental managers in California, licensed environmental professionals in Connecticut, review and evaluation licensed professional engineers in Illinois, licensed site professionals in Massachusetts, and certified professionals in Ohio. Ultimately, EPA decided not to specifically mention any certification programs, due in part to the com-

[19] *See* Parks, Christopher, *Building Green*, CRO Magazine, July-August 2007. On the Web at http://www.deloitte.com/dtt/article/0,1002,cid%253D171076,00.html.

[20] *See* Web site at http://www.astm.org/Standards/E2018.htm for ASTM Standard: E-2018-01 Property Condition Assessments.

[21] *See* http://epa.gov/brownfields/regneg.htm for EPA background on the AAI regulation published in 2005 (70 FR 66070, 11/1/05).

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plexity of regulating the various licensing groups. The only credentials recognized in the AAI rulemaking are licensed professional engineers and licensed professional geologists with three years of full-time experience. The rest of the definition of an EP is very flexible, reflecting the diverse backgrounds and experience levels of those practicing in the field. Although a baccalaureate degree is mentioned, it is not required of all EPs. EPs with at least 10 years of relevant experience are not required to have a Bachelor of Arts degree. The diverse backgrounds of EPs, with an emphasis on fieldwork and direct experience, are among the strengths that make them readily able to adapt to sustainability projects. Environmental professionals were not the result of a structured academic curriculum but rather came from a variety of starting points to help invent environmental due diligence in the 1980s and 1990s.

In the late 2000s, EPs and PCA consultants are in the forefront of inventing sustainability due diligence. The needs of the commercial real estate market call for cost-effective, practical, and responsive methods and tools. EPs and PCA consultants are thoroughly familiar with the real estate marketplace and the reality of fieldwork and time constraints. Some of the problems can be solved by architects and engineers on the drawing board, but many issues only can be surfaced through data analysis, fieldwork, interviews, and relevant experience. The real estate marketplace has its own constraints. Issues such as due diligence costs and transaction timing are critical factors. The environmental due diligence industry has begun to address these needs and will be an important stakeholder as sustainability due diligence standards evolve and eventually are codified at various regulatory levels.

The Role of ASTM

Given its history dating back to 1898 and a consensus-building approach that was a critical building block for adoption of uniform environmental due diligence standards, a debate is underway over ASTM's role in the development of uniform sustainability due diligence standards. ASTM organized a subcommittee on commercial real estate in 1989 for the purpose of establishing a standard practice for conducting all appropriate inquiry into the previous ownership and uses of a property required under the Comprehensive Environmental Response, Compensation, and Liability Act. After four years of hard work by a diverse group of professionals, the first ASTM E-1527 Practice for Phase I Environmental Site Assessment (ESA) was adopted and published, providing much-need national guidance and a standardized format. As a result of this standardization, the Phase I ESA industry began a period of rapid growth. The cost and time to complete a Phase I ESA dropped significantly as quality rose in response to the new national industry standard. Consultant liability concerns became more manageable with a widely accepted national standard specifying that a degree of uncertainty remained for this type of limited inquiry. In addition to establishing a Phase I ESA national industry standard, ASTM also established a less expensive screening tool, the environmental transaction screen, designed to enable anyone—not just environmental professionals—to review a series of standardized questions designed to identify "red flags" indicating likely or potential environmental problems. This screening tool has been highly controversial over the years and does not reach the level of AAI, yet it has remained widely used and popular because not all due diligence investigations are focused on the AAI objective of CERCLA liability protection. Some industry analysts suggest addressing climate change and sustainability matters as a non-scope item in the E-1527 Phase I ESA Standard.[22] Such analysis includes the potential incorporation of sustainability beyond a non-scope item into the legal definition of the innocent landowner defense, which was established by CERCLA and the subsequent Superfund Amendments and Reauthorization Act. Among other areas, this analysis focuses on requirements under the National Environmental Protection Act and equivalent state statutes, which recently have been interpreted by courts to include a review of climate change impacts associated with real estate. Given the maturity of LEED and specifically the LEED-EB standard, along with the broad-based national consensus already involved in continuously improving the standard, questions arise as to whether ASTM needs to reinvent the sustainability due diligence wheel considering the time involved in the ASTM process and the market's urgency for a standard. It appears the marketplace already is focusing closely on LEED as the baseline upon which to build a sustainability due diligence standard for the commercial real estate industry. While ASTM involvement in the LEED consensus-building process could be quite valuable, perhaps ASTM simply should incorporate by reference USGBC's LEED-EB stan-

[22] *Environmental Due Diligence in The Era of Climate Change,* Lawrence P. Schnapf, The Practical Real Estate Lawyer, May 2008.

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dard as a non-scope and potentially required element of its Phase I and PCA standards. It is likely upcoming ASTM E-50 committee and task group meetings will include further discussion on this issue.

(4) Process Item 4: Consultation and Public Disclosure

"For a Qualifying Fossil Fuel Generation Plant, the Financial Institution will encourage the Client to consult with affected constituencies, as part of its project development process. Depending on its scope and detail, a regulatory review process, integrated resource planning, or similar formal approval of the Qualifying Fossil Fuel Generation Plant by an independent regulatory body fulfills this requirement."

Reporting and transparency increasingly are important in the financial institution industry, and these principles should be a baseline component of the institutions' sustainable real estate management policies and procedures. With a typical commercial real estate asset, affected constituencies could include borrowers, customers, shareholders, tenants, and even neighbors that could be impacted in a positive or negative way by the sustainability objectives associated with a property. With new developments or significant retrofits, local building codes and regulations will reflect LEED-related or other unbranded sustainability principles and will become threshold review items by those involved in a project. Professional financial auditors involved with sustainability matters liken evolution in this area to that seen under the Sarbanes-Oxley regulatory apparatus, with significant impacts to the regulated community.

(5) Process Item 5: Reporting

"Each Financial Institution will periodically disclose the process by which they are implementing the Diligence Process. The purpose of the reporting is to demonstrate that:

- *the Diligence Process is being fully implemented, and*
- *environmental impact of transactions has been evaluated and the results of the evaluation are an important consideration in the financing.*

The reporting will include the number of completed transactions that were subject to the Diligence Process, and case studies of the types of effect the Diligence Process has on transactions. Recognizing that reporting is both important and sensitive, the Financial Institutions will maintain a dialogue with environmental stakeholders and clients focused on stakeholder needs and best practices."

As referenced above, many financial institutions already issue annual sustainability reports to shareholders. While most such disclosures contain broad principles and objectives, these institutions now are being asked to provide evidence of continuous improvement in this area. Such reporting requires the adoption of sustainable real estate management systems that can be integrated throughout the organization and establish accountability for executing tasks associated with meeting sustainability objectives. This process also facilitates the ongoing setting and adjusting of goals so progress can be measured and adjustments can be made as required.

(f) Industry Call to Action

The Carbon Principles, the emergence of LEED-EB, evolving climate change and sustainability regulations, and lessons learned from Kyoto Treaty countries have provided a useful starting point for U.S. financial institutions and the real estate industry to develop and implement consensus-based sustainability standards. Industry leaders who already have engaged in this effort have realized the short-term economic benefits that can be achieved for their stakeholders. These sustainability early adopters should enhance their role and participation in educational and leadership efforts to ensure this process is accelerated so the benefits can be rapidly and more broadly realized.

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