WHITE PAPER

WHY ESG IS KEY TO CONSTRUCTION

ADDING VALUE THROUGH MANAGED SUSTAINABILITY

ESG PRO

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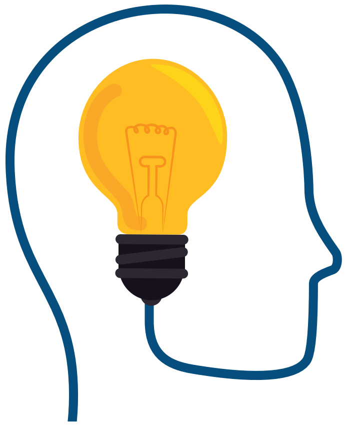


INTRODUCTION

WHY ESG IS A TOP PRIORITY

The pressure is most definitely "on" for the construction sector to embrace its Environment, Social, and Governance, or ESG, obligations. All UK companies bidding for government contracts worth more than £5m must commit to net zero by 2050 and, in the EU, the sector must manage the mandatory disclosure of the emissions potential of new buildings over their life cycle.

The sector remains responsible for as much as 40% of global energy consumption, and 30% of greenhouse gas emissions. Of this, 8% of global carbon emissions stem from the four billion tonnes of cement used every year.

Investors are demanding effective sustainability measures as these now dictate the future value of all building projects.

ESG is about a sustainability model in which people, planet, and profit are equals. From an industry perspective the huge commercial advantages to ESG reporting are clear for all to see.

At the board level, it's understood that attracting new clients and investment is a priority, just as there must be a push to insulate the business from exposures to D&O (Directors and Officers) litigation.

Your ESG approach must be substantiated, quantifiable, and long-range. This requires differentiating between specific measurable achievements and independent ratings for the design and construction of buildings.

Your ESG reporting is far more than BREEM, WELL, or LEED assessments. While important, these don't relate to your

firm's impact upon the community, your management of people, and the risks and opportunities which can propel your firm forward if well managed.

Your ESG reporting and the resultant rating is the ultimate "bird's eye view" of all that you are doing well. It's where your corporate social responsibility initiatives and internal carbon reduction plans all contribute.

The intention of this White Paper is to offer insight into these key ESG considerations.

The construction sector remains responsible for almost 30% of global GHG emissions

PERSPECTIVE

ESG, AND THE CHALLENGES FACING THE CONSTRUCTION INDUSTRY

It's clear that the construction industry's use of raw materials is a major source of concern when evaluating booth environmental and social matters,but the industry is hugely dependent upon finance and insurance too.

Insurers are evaluating multiple sustainability topics when evaluating construction -related risks, including the company's approach to designs which might have significant environmental impacts, such as works in protected areas such as wetlands.

Other factors include the use of mined raw materials and other natural resources, along with local regulatory considerations.

They're looking also at the company's ESG policy and how is this overseen, communicated, and implemented. This extends through to understanding the supply chain, because the reputations of the company's partners and suppliers have an absolute relevance.

Financiers are watching your firm's ESG performance too. Geoff Doherty, chief financial officer at Kingspan in Dublin has noted that environmental commitments and actions have attracted investment from specialist ethical funds. In September 2020 Kingspan raised €750 million through the sale of 'green bonds,' via funds such which select stocks based on strong ESG principles.

The firm went further in 2022 by taking a €700m five-year loan in partnership with an international banking syndicate which maintains strict ESG targets. The loan offers better rates if the company meets its ESG targets.

ESG reporting is about honesty and transparency, and it relies upon the integrity of the organisation too. Whilst CSR is about valuing people, ESG is about values, people, and planet: it quantifies stated values, and it adds value.

Mandatory climate reporting will become more widespread, as evidenced by TCFD reporting affecting privately owned companies too.

With increased transparency, there's a need for streamlined reporting. This allows any firm to communicate the benefits of its investment in ESG to both shareholders, regulators, and the wider public.

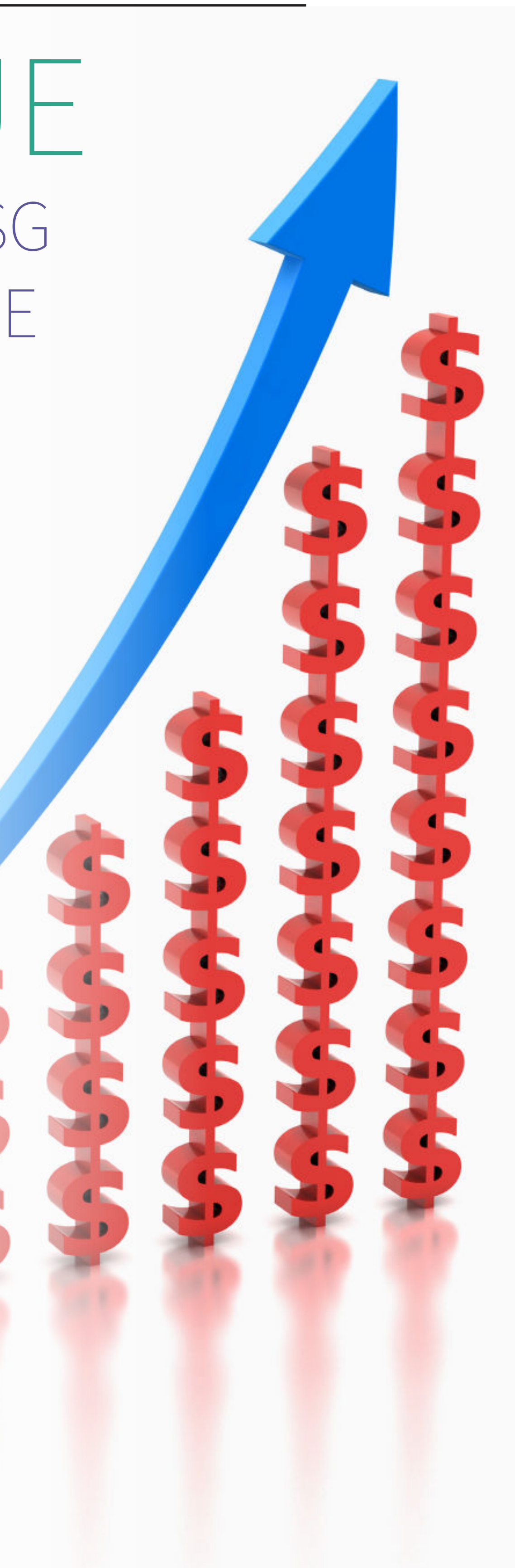
Change is inevitable and it will be those firms which embrace sustainability who will dominate the leadership positions in their specific sectors.

ADDED VALUE

THE ARGUMENT THAT ESG ADDS VALUE IS ABSOLUTE

When corporations pay attention to environmental, social, and governance (ESG) concerns, countless studies highlight that their returns are enhanced.

Analysing the results of >2,000 studies on the impact of ESG propositions on equity returns, McKinsey found a 63% positive return vs. a mere 8% negative[1].



Companies which embed effective ESG practises generate profitability increases of 20%

Stronger ESG ratings have a strict correlation with reduced downside risk and better credit ratings, and investment in ESG delivers reduced costs and enhanced productivity.

A 2015 metastudy of more than 200 sources by Oxford University and Arabesque Partners[3] noted that "80% of the reviewed studies demonstrate that prudent sustainability practices have a positive influence on investment performance. This is supported by World Economic Forum (WEF) research which shows an average profitability increase of 20 percent for companies which embed effective ESG practices!

GREENWASHING

DON'T RISK YOUR REPUTATION

There are dangers to any firms which dare to underestimate the emotive impact of ESG issues. At stake is near-certain damage to a company's reputation and profit margins.

In 2020, the Competition and Markets Authority (CMA) discovered that 40% of green claims made online from companies could be misleading, particularly the construction sector.

Imagine the impact of the press revealing modern slavery in your supply chain, and what of dumping of illegal waste? Such scenarios are all too real, made worse by the reality that it's so often not the prime contractor which commits the breach. The emphasis is very much upon you to be in total control of your supply chain.

Doubtless, you've invested in Corporate Social Responsibility (CSR), and your on-site practises are above reproach, but public and commercial claims as to your corporate sustainability must be validated. The risk of greenwashing is very real.

'Green-fatigue' is real, and regulators are clamping down. Put bluntly, 'greenwashing' is an accounting fraud, in that there is often a discrepancy between reported and actual behaviour, and executives face personal culpability.

Sustainability delivers social and financial benefits, and it's tempting to make bold claims or to declare goals to keep pace with the competition. Green marketing is effective because buyers willingly pay a premium, according to McKinsey's buying habits research.

The problems arise through ambiguity as to what 'sustainable' actually means. To claim your firm is 'green' requires more than purchasing carbon offsets or 'green' imagery on your website!

Be wary of emphasising any "green" aspects of your construction approach such as highlighting a sustainable appearance by hiding conventional design. Think twice about energy efficiency systems which have just been introduced in the design merely to comply with green construction regulations, but which may be unproven or of little true value.

Pay attention to both your group's internal activities as well as those across your supply chain. Query claimed 'sustainable' product or service attributes, demand evidence, and examine worker conditions with equal thoroughness.

It is precisely because ESG reporting relies on evidence-based data that the risks due to greenwashing can be mitigated.

According to SpringerLink, "Environment, social, and governance (ESG) risk is the consideration of non-financial risks arising from the environment and sustainability, reputation, or brand, legal, technological,

product or service quality, labour, ethical conduct, compliance, and strategic considerations."

To summarise, greenwashing is very much a key ESG risk, and requires careful risk management. The role of ESG reporting in this context is to ensure that the necessary action-plans are in place, together with appropriate stakeholder engagement to ensur

Green marketing is effective because buyers willingly pay a premium, according to McKinsey's Buyer Habits Research

ESG FACTS

WHY ESG MUST BE YOUR PRIORITY

- **10%** is the typical reduction in the cost of capital for firms with superior ESG scores (KPMG)
- **31%** of industry spend is via public sector ESG weighted public procurement (EY)
- **98%** of investors report they are evaluating ESG performance as a key risk criteria (EY)
- **45%** of all UK GHG emissions are due to the construiction industry (DLA Piper)
- **62%** of all UK waste is generated by construction, dwarfing household waste (DLA Piper)

ESG REGULATION

PREPARE FOR THE UNAVOIDABLE

As of Summer 2022, the UK has no single ESG law or regulation. The UK's ESG regime consists of domestic and EU-derived laws and regulations, many of which are not ESG-focused but which have an influence.

The UK considers the directors of UK quoted companies already subject to the key themes of human rights and environmental management issues via their annual reporting obligations. Be warned, though: since April 2022, TCFD (Taskforce for Climate-related Financial Disclosures) is mandatory for all firms, public and private, with more than £500m turnover and more than 500 employees.

TCFD reporting can be complex, as its starting point both carbon accounting, and ESG reporting. It's then about reporting the financial risks and opportunities an organisation may encounter as a result of climate change.

Other than TCFD, the UK's ESG legal landscape is fragmented, with a wide range of laws and regulations with which all businesses (big and small) must comply. These include the UK Corporate Governance Code 2018 (the "UKCGC"), the directors' duties in the Companies Act 2006 (the "Companies Act"), the Listing Rules, the Disclosure Guidance and Transparency Rules (the "DTRs"), the UK Stewardship Code 2020 (the "UKSC"), the Large and Medium-sized Companies and Groups (Accounts and Reports) Regulations 2008, the Climate Change Act 2008 (the "CCA 2008"), and the Bribery Act.

Globally, the European Commission CSDDD (Corporate Sustainability Due Diligence Directive) will force many strategic and operational changes, as will the CSRD. These will affect countless organisations which export to, or conduct operations in, Europe. CSRD obligations will apply from 1 January 2024.

The US Securities Exchange Commission (SEC) adopted mandatory climate change disclosure reporting in the annual reports and registration statements of public companies registered with the SEC, including any company (domestic or foreign) whose stock is listed on a U.S. stock exchange.

Our position is that the real dangers are to be found in the combination of regulatory enforcement investigations and consumer activism. A case in point is the claim by Client Earth against KLM airlines in which they allege misleading advertising and breach of consumer and competition law standards.

Client Earth's challenge is clear: "with a view to climate change, there is no such thing as 'more sustainable' or 'responsible flying,' and that the only sustainable thing KLM can do is to fly fewer planes".

The UK's Advertising Standards Agency ("ASA") is processing many similar sustainability claims, and will soon release their findings as to the public's understanding of terms such as "carbon neutral" and "net zero", and there's little doubt that both NGOs and consumer activists will then seize on such findings and bring further challenges both in the UK and across the EU.

The picture is similar in the USA, where Directors and Officers litigation will rapidly up the ante in the high stakes of corporate ignorance in respect of environment, social, and governance behaviour. Expect to see more of this sort of litgation in the United Kingdom.

Since April 2022, TCFD reporting is mandatory for almost all firms, public and private, with more than 500 employees.

STAKEHOLDERS

YOUR MATERIALITY ASSESSMENT IS CENTRAL TO SUSTAINABILITY SUCCESS

Materiality is the principle of defining the environmental, social, and governance topics which matter most to your stakeholders. Of your entire ESG reporting journey, few things can be considered to be of equal importance than how you incorporate and prioritise the views of your stakeholders.

New regulations such as mandatory climate reporting and the European Directive on non-financial reporting and the UK TCFD are prompting businesses of all sizes to re-consider the material topics on which to report.

The process begins by accepting that your stakeholders include those who are external to your own operations. You must think beyond your Executive, and consider your workforce, the entire supply chain, the community, and beyond.

We lead the materiality assessment process with close reference to the principles set forth by Global Reporting Institute (GRI) and the Sustainability Accounting Standards Board (SASB), because these are the two frameworks most widely recognised and accepted.

When conducted rigorously, such assessments demonstrate the good governance of your organisation. You will discover, there are many approaches to making the process as smooth and effective as possible.

In construction, your stakeholders extend beyond your clients and employees to environmental specialists; alliance partners; special interest groups; people with academic or research interests related to a targeted issue or population, and many others.

When organisations consider how sustainability topics interrelate with their business strategy and then link sustainability with risk, they strengthen their operations.

The benefits of better informing your stakeholders are revealed not only through greatly improved employee, investor, and customer confidence, but extend also through to those concerned with regulatory oversight.

Because stakeholder engagement is at the beginning of the ESG and sustainability reporting process, and continues throughout its life-cycle, it is the most effective approach to stimulating the added value for which ESG is known.

CARBON

GHG MANAGEMENT ISSUES ACROSS THE CONSTRUCTION SECTOR

When discussing carbon accounting, we are referring to the equivalent carbon generated by a collection of climate impacting greenhouse gasses (GHGs).

These emissions fall into three categories, or scopes, summarised in the figure overleaf. Scope 3 emissions are typically greater than the other two combined, but to achieve carbon neutrality, all three types of emissions and their sources must be identified and measured.

Together, building and construction are responsible for roughly 40% of all carbon emissions in the world, with operational emissions - those from energy used to heat, cool and light buildings - accounting for 28%. Embodied carbon accounts for the 11% balance, being the carbon generated through the raw materials and the actual construction practises related to the whole building life-cycle.

The World Business Council for Sustainable Development study co-authored by Arup which found that of the six buildings in its case study that the whole-life carbon footprint was around 1,800 kilogrammes of CO2 equivalent per square metre. No wonder the industry is investing in better architecture and more modern materials.

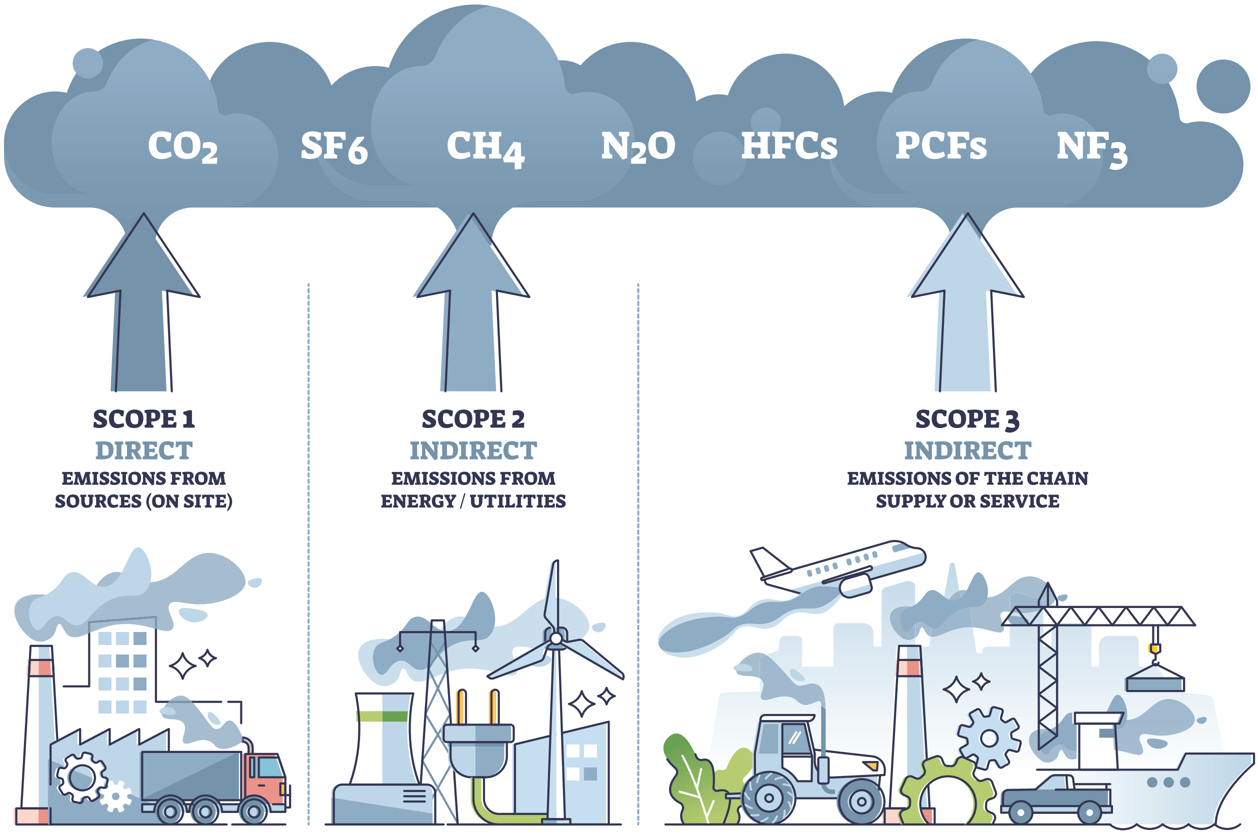
The outcome is best summarised by the International Energy Agency (IEA), which estimates that, by 2030, direct building CO2 emissions need to fall by 50 per cent, and that indirect building sector emissions by 60 per cent. In other words, building sector emissions will have to decrease by around 6 percent annually until 2030.

From a UK perspective, the National Engineering Policy Centre (a partnership of 43 of the UK's professional engineering organisations led by the Royal Academy of Engineering), the UK's construction sector must de-carbonise in line with the national emission reduction targets of 68% by 2030 and 78% by 2035.

The sector must define and promote the large-scale adoption of best practices in low-carbon procurement and construction, applying it to all new build and refurbishment projects by 2025.

Apart from government procurement mandates, such as PPN06/21 which is having an impact across the entire industry, this impetus must be underpinned within the industry itself by improved usage of digital technologies to improve productivity and reduce risk, an example of which is the use of digital twins.

SCOPES OF EMISSIONS



One example of industry collaboration to reduce embodied carbon is the proof-of-concept "Part Z" proposal to amend existing UK Building Regulations to mandate a whole life carbon assessment and limiting of embodied carbon emissions as part of the building design process.

The proposal is supported by a number of major construction industry players, and it aims to normalise the calculation, reporting and limitation of embodied carbon emissions at the outset of a qualifying construction project.

Time will tell as to what might work, but there has never been a more important time for every part of the construction industry supply chain to wake up to carbon emissions and to minimise their contribution. This, after all, is the new competitive edge.

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LEVERAGE CSR

INTEGRATING CSR AND SOCIAL VALUE

Contrary to the opinion of some commentators, ESG and CSR are entirely complimentary: ESG is a scoring and reporting mechanism with which to measure the impact of a Social Responsibility policy.

So close is the alignment, that a well founded CSR strategy, especially when accredited (audited), may equate to almost 30 percent of your ESG reporting process.

CSR is an invaluable methodology to build a strong organisational culture underpinned by shared social values and purpose. The contrast with ESG is that the latter is more focussed on creating opportunity and identifying business risks. Put simply, CSR is about values, and ESG is about value.

CSR is centred on the concept that the organisation has responsibilities to the community, environment, and society. Its goal is to demonstrate an organisation's charitable and ethical responsibilities. CSR obligations reflect a company's beliefs and culture, and each organisation chooses the CSR efforts which make the most sense for them.

While CSR aims to attempts to hold organisations accountable in terms of their societal responsibilities, it has always tended to lack the governance to measure impact.

ESG looks at the wider picture and its standards integrate environmental and social responsibility into corporate strategy and governance. The very essence of ESG is that it has measurable goals and impacts. In short, it's evidence-driven.

Unlike CSR, ESG is concerned with organisational strategy. We've seen how strong ESG metrics can influence people, with some studies reporting that 35% of people would pay 25% extra for sustainable products and services, and a staggering 76% of consumers are inclined to boycott companies which are unsustainable or have poor employment practices.

Investors want to know a company's social and environmental impact. Of all institutional asset owners, 95% are seeking sustainable investing methods.

Today's risk landscape is volatile. Risk is now more environmental and social than economic. Seven of the top ten likely hazards, and eight of the top ten impactful risks, are related to environment, social, and governance.

Failure to meet both ESG and CSR criteria can hurt a company's finances and reputation. Not fulfilling emission reduction goals can lead to downgrades and share price losses, while not improving pay and working conditions can lead to high attrition and productivity loss.

As the construction industry becomes even more regulated, firms will need risk management and compliance tools to combine pertinent data, automate processes, and assure error-free reporting.

Your most important stakeholders demand quantitative, measurable action from businesses and the ecosystems in which they operate. A combined approach is key: corporate strategy and growth should be based on the proper auditing and certification of both ESG and CSR.

Corporate strategy and growth should be based on the proper auditing and certification of both ESG and CSR

ESG PRO

TOTAL SUSTAINABILITY MANAGEMENT AND GLOBAL PARTNERSHIPS

The mission of ESG PRO is to enable our clients across all sectors to demonstrate the exceptional change which adds value to both the organisation and to society.

ESG PRO is remarkable in its client-centric approach: we are small enough to care, and powerful enough to deliver. Supported by the 450 staff across our group, we are entirely results-driven.

Whether yours is a regional construction firm or a global brand, our teams are able to manage your entire ESG and Sustainability journey. We even advise governments seeking sustainable solutions for the management of the cultural and heritage impacts of tourism and travel.

We're global in scope, with clients spanning SE Asia, the Middle East, Europe, and the Americas. Our approach is unique too: we control costs by conducting the majority of our work remotely.

ESGPRO

GLOBAL EXPERTISE

- ESG reporting consultancy
- ESG ratings management
- Carbon reporting and management
- Carbon neutrality and verification
- CSR accreditation
- Social Value (TOMS) certification

REFERENCES

MAIN ARTICLES

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