Sustainable Hospitality Alliance

Business Case for Sustainable Hotels

Recommendations for hotel investors and asset managers

March 2020

In collaboration with

IFC International Finance Corporation WORLD BANK GROUP

Creating Markets, Creating Opportunities

Executive summary

Climate crises and the hospitality industry

Global emissions grew more quickly between 2000 and 2010 than in each of the previous three decades,[1] and every decade since the 1960s has been warmer than the one before.[2] The rising emissions are accelerating climate change with considerable impacts across communities and ecosystems, businesses and economies.

The hospitality industry is particularly exposed, with extreme weather events increasing the cost of operations whilst simultaneously decreasing the popularity of some destinations across the world. The water crisis in Cape Town in 2018, for example, led to up to a USD 65 million shortfall in the region's hospitality industry.[3] This provides a stark illustration of direct risks to businesses if we fail to prepare for sustainability-related crises.

Like other industries, the hotel sector is a growing industry that needs to limit its carbon emissions. Our research identified that the industry needs to reduce its carbon emissions by 66 per cent per room by 2030 and 90 per cent per room by 2050[4] to ensure that the predicted growth does not lead to a corresponding increase in carbon emissions.

However, the complex business model – whereby hotels are built and owned by different businesses or individuals than the brands and companies that run them – can hinder the ability to implement sustainable solutions or operate more sustainably. There is a need to engage across the industry value chain from owners and investors to brands, operators and franchisees, to encourage a more joined up approach to building, refurbishing and operating a hotel.

In collaboration with International Finance Corporation (IFC), we have prepared this business case so the benefits of sustainability – financial, reputational and regulatory – can be fully recognised for every stakeholder and fully implemented as a consequence.

Action is not just necessary to protect destinations and communities but, as this research reveals, will be the only way to ensure hotels and operations are future proofed and will yield considerable benefits for all stakeholders in both the short and long term.

> **"As the UN Sustainable Development Goals have shown, the risks of not acting are too big to overlook, but so too are the opportunities to reduce costs, increase revenue, and future proof your properties and investments."**
>
> **Madhu Rajesh, Director, Sustainable Hospitality Alliance**

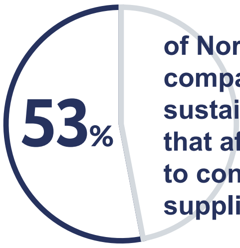
The business case for sustainable hotels

Far from being an impediment to business, sustainable hotel design in new builds and retrofits offers considerable benefits for all stakeholders.

1. Boost profit margins through utility savings

A sustainable building is at least 20% more resource efficient, which reduces utility costs. Savings can be shared between owners and operators through green leasing agreements.

Sustainability upgrades have a typical payback period of less than one year in utility savings for new builds and from one to ten years for retrofits (IFC)



of North American companies have corporate sustainability programs that affect their decision to contract with a travel supplier (GBTA)

2. Increase revenue through satisfying consumer preference and reducing reputational risk

Demand among individual and business travellers for greater environmental sustainability is increasing and travellers are looking for more transparency to inform their decisions. Businesses are increasing scrutiny on sustainability during RFPs and reviews of hotel companies.

3. Future proof investment strategies

Investing in hotel portfolios with strong environmental, social and governance (ESG) metrics and brand reputation mitigates future risk to revenue and opens doors to green finance mechanisms such as ESG-linked loans and green bonds created by financial institutions (e.g. IFC), banks and REITs.

IFC has financed $5.4 billion in green buildings, of which almost $1 billion were green hotels

Mandatory national schemes such as NABERS in Australia have saved $870 million in energy bills since 2010 for commercial building owners and managers

4. Safeguard against regulatory risk and benefit from incentives

Governments and cities worldwide are introducing a wide variety of penalties such as carbon taxes or restrictive water policies, and inducements such as VAT forgiveness, expedited permitting and property tax incentives to encourage sustainable design.

5. Increase value and validation through certification

Certifying hotel buildings increases their value and competitiveness today and for the future, ensuring their alignment with the latest sustainability requirements, while also providing credible evidence for government schemes and customers.

Average daily room rate of hotels in the United States (CHR)

Commercial PV system cost decrease between 2010 and 2018 (NREL)

6. Ensure a long-term energy supply

Most renewable energy sources are now cheaper than fossil fuels, and investing in hotels' on-site renewable power can increase security and control over supply and costs.

Recommendations for hotel investors and asset managers

Background and key arguments

Responsible investment and profit are no longer mutually exclusive. Investors can now expect stable and strong dividends from REITs that invest in sustainable properties because sustainability measures considerably improve risk management and assessment of a portfolio.

The top institutional and private shareholders of some of the largest hotel chains are deeply focused on sustainability; it is a strategy that yields high returns and mitigates future risk.

Research shows that green REITs shares have higher operational and value benefits through:[4]

- higher cash flows overall (funds from operations and earnings)
- decreased corporate-level expenses (interest), resulting in increased cash flows available for distribution
- trading at a higher relative value (price to net asset value)
- substantially lower volatility experienced than traditional REITs.

Key recommendations for hotel investors and asset managers

1 Include environmental, social and governance (ESG) metrics in your investment analysis

ESG metrics enable you to identify the performance of your current and future hotel assets and correlate to a better risk-adjusted ROI in the long term. Since 1990, sustainability-based indexes (MSCI KLD 400 Social) have provided better long-term returns than traditional indexes.[5]

How to do this:

- Start with guidance from the CDC ESG Toolkit for hospitality.
- Develop an ESG and climate strategy using recommendations from UN Environment.

2 Use the opportunities provided by sustainable finance

According to IFC, green investment needs to double to meet the Paris Agreement 2030 targets. Issuances of green bonds by corporates and non-corporates alike has proven to be in high demand among investors.

- Select projects aggregated at portfolio level, which have higher eligibility to receive green finance.
- See UN Principles for Responsible Investment for more information.

How to do this:

3 Prioritise green incentive schemes

Prioritise investment in countries and cities with government green incentives and use your lobbying power to convince local and national governments to launch incentives in places where these are not currently offered.

- Visit IFC's EDGE website to see which governments are offering incentives in developing markets.
- See the C40 cities global network to identify the cities committed to addressing climate change.

4 Prioritise sustainable buildings in your investment strategies

Sustainable hotels are at least 20 per cent more resource efficient compared to their local market, increasing their long-term resilience to both policy and environmental change. Therefore, investors can develop a well-diversified portfolio of sustainable properties that expands across geographies and types of hotels.

- Use benchmarking reports such as the *GRESB Real Estate Assessment* and Cornell Hotel Sustainability Benchmarking Index to identify hospitality companies and owners that are committed to improve the sustainability of their portfolio.

5 Inspire long-term action

The ownership of a building changes through its lifetime and investors have a unique role in setting a sustainable pathway for the property's entire lifecycle.

- Introduce sustainability criteria and reporting requirements for your assets for the various phases from design to asset sale.

Case study – BlackRock

BlackRock, the largest asset management company in the world, announced in January 2020 that it would put sustainability at the heart of its investment decisions.[6] Some of the key principles of the BlackRock Sustainability Mission Statement are:[7]

- A responsibility to monitor the companies that are part of their portfolio of investments.
- Clients' interests are protected by engaging portfolio companies through private and public channels.
- As a fiduciary investor, evaluating how companies manage the material sustainability-related risks and opportunities within their businesses.
- An intrinsic relationship between risk-adjusted returns and sustainable practices.

BlackRock is one of the top shareholders for brands such as Marriott International, Hyatt and Hilton and widely communicates its commitment to sustainability.

We believe that companies with sound corporate governance practices, including how they manage the environmental and social aspects of their operations, better mitigate risk over the long term, and offer better risk-adjusted returns.

Sustainable Hospitality Alliance

Responsible hospitality for a better world

Further information

Sustainable Hospitality Alliance brings together hospitality companies to address social and environmental challenges and develop practical resources and programmes for the industry. We welcome collaboration with all areas of the hospitality industry including investors, owners and operators.

To download the full report visit: www.sustainablehospitalityalliance.org/business-case

If you are interested in joining our engaged membership, please contact us: info@sustainablehospitalityalliance.org

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