LATIN LAWYER

THE GUIDE TO ENVIRONMENTAL, SOCIAL AND CORPORATE GOVERNANCE

Editors
Antonia Stolper and Robert O'Leary

The Guide to Environmental, Social and Corporate Governance

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Publisher's Note

Latin Lawyer and LACCA are delighted to publish *The Guide to Environmental, Social and Corporate Governance*.

Edited by Antonia Stolper and Robert O'Leary, partners at Shearman & Sterling LLP, this guide brings together the knowledge and experience of leading experts from a variety of disciplines and provides guidance that will benefit all practitioners.

Environmental, social and governance (ESG) matters are taking centre stage in Latin America. The region has some of the most biodiverse ecosystems in the world, all of which are highly vulnerable to the increasingly significant effects of climate change, not to mention that many of its economies are heavily reliant on extractive industries and other sectors that depend on those natural resources and ecosystems. In addition, there is a need to narrow sizable socioeconomic gaps and improve gender equality across Latin America, all of which have led to a boom in sustainable finance involving both sovereigns and corporates in recent years. For companies operating in the region, it has become increasingly clear that not having an ESG strategy in place can jeopardise the primary goals of maintaining profitability and staying competitive. Pressure from both investors and consumers means that businesses of all sizes have been seeking the advice of outside counsel in order to mitigate risks, but also to identify opportunities. This Guide draws on the expertise of highly sophisticated practitioners to draw out trends and outline the tools needed to navigate the fast-moving ESG landscape across the region.

We are delighted to have worked with so many leading firms and individuals to produce *The Guide to Environmental, Social and Corporate Governance*. If you find this useful, you may also like the other titles in the Latin Lawyer series, including *The Guide to Mergers and Acquisitions*, *The Guide to International Arbitration in Latin America*, *The Guide to Restructuring*, *The Guide to Corporate Compliance* and *The Guide to Corporate Crisis Management*.

My thanks to the editors for their vision and energy in pursuing this project and to my colleagues in production for achieving such a polished work.

Contents

PART II: ESG TRENDS AND PRACTICES

Introduction

Antonia Stolper and Robert O'Leary[1]

Environmental, social and governance (ESG) criteria are evolving as reporting and investment metrics at a rapid pace. While the term 'ESG' and the push to integrate ESG criteria into a central role in corporate reporting and investment are relatively new, as a conceptual matter ESG has been on the minds of regulators and corporate monitoring organisations for several decades. The recent increased focus on ESG criteria can be viewed as a call for companies to take a longer-term view of enterprise value, in contrast to focusing so heavily on short-term financial returns. Indeed, to some observers the ESG movement is something of a re-examination of – or even, a referendum on – the modern capitalist focus on maximising returns above all else.

At its broadest, incorporating ESG criteria into business activities requires a more holistic and people-centric approach to business. Countries that require ESG reporting and companies that are benchmarking their operations against ESG standards are declaring their intention to prioritise environmental, social and governance criteria. ESG touches all aspects of a business and has short-, medium- and long-term implications. That being said, 'measuring' ESG performance is a monumentally complex endeavour, and Latin America – and the world – continue to grapple with how to do so.

For investors, environmental, social and governance considerations are a growing priority as ESG performance has been shown to correlate strongly with financial performance. Stock prices of companies with high ESG rankings tend to be more stable. In contrast, companies that experience controversial ESG events can see their stock lose significant value in the market. Among society's many current challenges, climate change, social inequality and diversity are

1 Antonia Stolper is of counsel and Robert O'Leary is counsel at Shearman & Sterling LLP.

often top of mind, and the ESG movement seeks to engage private companies in addressing such issues by requiring that they report on their performance with respect to such ESG matters. What is made clear by the chapters in this book is that all levels of governments, international governmental organisations and non-governmental organisations are grappling with ESG and how to ensure that ESG considerations are primary in governmental and corporate decision-making. Stakeholders and regulators are using a combination of ESG adoption, measurement and accompanying disclosure to try to achieve this.

While climate change concerns are often used synonymously with the term 'ESG' in the media and in common parlance, it is helpful to recall that ESG is comprised of three separate components: environmental, social and governance. Environmental standards refer to a company's or government's environmental impact and environmental risk management practices. Factors when assessing a company's or government's environmental impact could include greenhouse gas emissions, water quality, waste management and energy efficiency. Social criteria refer to a company's or government's relationship with its employees, consumers and society at large, including its performance with respect to human rights, labour standards in the supply chain, child labour laws, workplace health, community impacts and safety. Finally, governance refers to how a company or government is managed or led with respect to its different stakeholders. This criterion relates to a well-defined corporate governance system that supports a company's long-term strategy.

Politics are inherently embedded at all levels of ESG efforts. Although, as noted above, the scope of ESG criteria is much broader, recently climate change has been the primary motivator for the heightened focus on ESG criteria. Climate change was the focal point of the Paris Agreement of 2016. UN member countries committed in the Paris Agreement to try to limit the global temperature increase above pre-industrial levels to 1.5°C, which does not appear likely to be achieved.[2] The signatory countries followed up the Paris Conference with the UN Climate Change Conference in Glasgow (or COP26), which took place in November 2021 and resulted in the Glasgow Climate Pact. Among other commitments, the countries agreeing to the Glasgow Climate Pact targeted a 45 per cent reduction in global carbon dioxide emissions in order to reach net zero by 2050.

2 See 'The world is going to miss the totemic 1.5°C climate target', *The Economist*, 5 November 2022, available at https://www.economist.com/interactive/briefing/2022/11/05/the-world-is-going-to-miss-the-totemic-1-5c-climate-target.

At the time of writing, UN member governments had just concluded the UN Climate Change Conference in Sharm-el-Sheik, Egypt (or COP 27), and one of the resulting agreements was that developed and high-polluting countries will compensate the developing countries that are hardest hit by the impacts of global warming. On the other hand, COP27 was itself controversially accused of promoting greenwashing. Both the venue – Egypt, a country with a significantly checkered record on human rights – and one of the main sponsors – Coca-Cola, the world's largest plastics polluter – were openly challenged in the global media with respect to their involvement in the event.[3]

In each country, the regulation of ESG disclosure has fallen mainly on securities and stock exchange regulators. There is something of a natural fit for these authorities given that they already regulate financial reporting and projections. In certain countries such as the United States, Latin America's most important trading partner, there is currently a wave of political backlash against the focus on ESG as an investment strategy and as a regulatory topic, with certain politicians and pundits railing against the use of ESG criteria as an investment tool or subject worthy of regulatory oversight. Nevertheless, given that ESG criteria are at base a tool for measuring long-term enterprise value, the political backlash will likely amount to more noise than actual policy. Major businesses have already made ESG criteria an important investment and evaluation tool and are seeking to promote themselves as ESG-friendly.[4]

In a region such as Latin America, where economic development is critical and there is a substantial energy and infrastructure gap, balancing ESG frameworks and standard-setting with development goals can be difficult. Though many governments and companies in Latin America are rightfully pursuing more sustainable energy, infrastructure and industry practices, the need to develop and maintain economic stability for their citizens in the short- and medium-term will still often take precedence. The challenge is to balance the short-term demands of electoral politics and putting food on the table with the longer-term threats to the planet and society that can result from a failure to deal with the issues encompassed by ESG. Many of the countries, if not most, in the region have

3 See 'At COP27 in Egypt, Climate Change Accountability Will Be Challenging', Posner, Michael, *Forbes*, 21 October 2022, available at https://www.forbes.com/sites/michaelposner/2022/10/21/at-cop-27-in-egypt-climate-accountability-will-be-challenging/?sh=3fd228991bbc.

4 See 'The tenacity of ESG investing', Buttonwood, *The Economist*, 16 November 2022, available at https://www.economist.com/finance-and-economics/2022/11/16/the-tenacity-of-esg-investing.

a significant percentage of impoverished citizens and large informal economies – people living and trying to survive under such circumstances can hardly be expected to make ESG-mindedness a priority. Some smaller, relatively wealthier, and more homogeneous countries, such as Costa Rica and Chile, have shown an ability to redirect their political economy towards an ESG-centric approach in relatively short order. On the other hand, larger, more diverse, and populous countries in the region are finding it much more challenging to prioritise ESG criteria while balancing development needs.

This book will examine the ESG movement across a variety of timely topics. There is a mix of topics and approaches – a couple of the chapters are partial surveys, in particular Chapter 1, which looks at the developing reporting landscape, and Chapter 3, which looks at the range of ESG-related financing products available in the international and local financial markets. Other chapters are monographs, which take a deep dive into how a particular country is dealing with a particular ESG issue. It is a truism, but each country in Latin America is unique in its history and current politics; nevertheless, countries can learn from each other and can adopt ideas that are working in one country and apply them in another. Likewise, legal practitioners in the region can draw on the observations, lessons learned and successes highlighted in this book to better execute ESG-related transactions in their practice, and to help them influence and shape ESG policy in their countries. The ESG movement is dynamic politically and economically and lawyers play an important role in the shape and direction it takes.

The first half of the book reviews ESG's influence on regulation, corporate practices, financing tools, country policy and disputes. Chapter 1 examines the current state of play with respect to ESG framework and standard-setting, including the potential for greenwashing and the likelihood of more consistent standardisation in reporting. Chapter 2 reviews what is happening in the corporate boardroom and how companies are addressing surging ESG reporting requirements. Chapter 3 reviews the range of financing instruments being utilised to generate sustainable development and the preservation of natural resources, such as blue and green bonds. Chapter 4 reviews the steps that Costa Rica is taking to translate its COP26 commitments into concrete action at home. Chapter 5 reviews the current landscape of ESG-related litigation and arbitration.

The second half of the book dives into specific ESG-related trends and practices. Chapter 6 takes a hard look at the essential nature of the social licence in the natural resources sector in Mexico, including recent case studies, lessons learned and what steps extractive companies can take to ensure they remain 'onsides' with the local communities in which they operate. Chapter 7 examines the evaluation tools that private equity investors are using in Latin American when making

ESG investments. Chapter 8 discusses ESG trends in commercial real estate investment in Brazil, while Chapter 9 reviews ESG in the real estate industry in Mexico. Chapter 10 examines the state of the carbon credit markets in Latin America and the extent of their success. Chapter 11 looks forward at the opportunities for green energy in Latin America, its potential and likely challenges to its growth.

The book concludes with information about the many contributing authors and provides their contact information.

As editors, we want to especially thank our colleagues who are not named authors herein but who contributed significantly to the editing of the chapters in this book, including Dan Feldman, Mehran Massih, Malcolm Montgomery, Chris Ryan, Cynthia Urda Kassis and Dhruti Tummalapalli.

Part II

ESG Trends and Practices

CHAPTER 9

ESG in the Real Estate Industry in Mexico: General Overview

Diego Gómez-Haro Katznelson, Rafael Villamar-Ramos, José Miguel Ortiz-Otero, Oscar Alejandro Quiroz-Chávez, Claudia Georgina García-González and Franco Rafael Guizar-Iriarte[1]

In recent years, there has been a substantial increase in appetite for sustainable real estate projects in Mexico. Among other reasons, this is because efforts to reduce the property sector's environmental impact are creating new ways to increase returns worldwide, and Mexico is no exception. Leading investors are favouring green strategies and, if that tendency continues to grow, it could lead to higher occupancy, higher rents, higher tenant retention and higher overall value.

There are new benchmarks for real estate projects, such as carbon neutrality, net zero energy and regenerative design. Investors are becoming familiar with initiatives such as LEED Zero, LEED Positive; EDGE Zero and Race to Zero.[2]

1 Diego Gómez-Haro Katznelson and Rafael Villamar-Ramos are partners, José Miguel Ortiz-Otero, Oscar Alejandro Quiroz-Chávez and Claudia Georgina García-González are senior associates and Franco Rafael Guizar-Iriarte is an associate at Sánchez Devanny.

2 LEED Zero, is a complement to LEED that verifies the achievement of net zero goals in existing buildings. LEED Zero Carbon recognises net-zero carbon emissions from energy consumption through carbon emissions avoided or offset over a period of 12 months. LEED Zero Energy recognises a source energy use balance of zero over a period of 12 months. LEED Zero Water recognizes a potable water use balance of zero over a period of 12 months. LEED Zero Waste recognizes buildings that achieve GBCI's TRUE certification at the Platinum level. LEED Positive is grounded in the belief that all buildings can start where they are to move towards becoming regenerative. LEED Positive will encourage development that allows buildings to become a vehicle for environmental restoration and repair. EDGE Zero is an innovation of International Finance Corporation, a member of the World Bank Group, EDGE makes it easy to design and certify resource-efficient and Zero Carbon buildings. Race to Zero is a UN-backed global campaign to rally leadership

Sustainability is becoming increasingly important to investors, as environmental, social and governance (ESG) compliant projects add long-term value to real estate assets.

In Mexico, there is still important work to be done towards having proper and sufficient legislation for regulating ESG; however, due to the increase of sustainable projects (green projects), together with an influx of private sector initiatives, we foresee that in the near future investors and other participants can expect to be impacted by ESG legal and regulatory disclosures, which will require expert legal advice. Taking advantage of this preparation period could help participants become more competitive in the real estate market.

How is Mexico catching up in ESG?

The legal framework

On 25 September 2015, the General Assembly of the United Nations (the General Assembly) adopted the 2030 Agenda for Sustainable Development (the 2030 Agenda) whereby its 193 members established several policies and actions to achieve prosperity, eradicate poverty and enhance peace and freedom among all countries. To achieve such ambitious objectives, the General Assembly agreed to focus on 17 sustainable development goals (SDGs), which, jointly considered, cover the three dimensions of sustainable development: economic, social and environmental.[3]

The 2030 Agenda is considered the main instrument by which all sectors of each member's constituency are held accountable, including governments, companies, non-profit associations and individuals. Every sector is equally important in achieving the 17 SDGs and the 2030 Agenda has established several duties for each one. For instance, the main pledge for governments, which are considered to be the main actors promoting efforts to achieve the 17 SDGs and their objectives, is to map, support, advocate for and report on the efforts related to achieving such objectives. Additionally, one of the main and most direct requests made of every country is to include actions in their national development plans, strategies and policies the pursuit of which will accomplish the 2030 Agenda's

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and support from businesses, cities, regions and investors for a healthy, resilient, zero carbon recovery that prevents future threats, creates decent jobs and unlocks inclusive, sustainable growth.

3 UNGA, 'Transforming our world: the 2030 Agenda for Sustainable Development', 17th session, A/RES/70/1, 25 September 2015.

objectives. The 2030 Agenda became not only a formal statement of goodwill for signing countries, but one of the main instruments by which countries will measure sustainability over the coming years.

In direct response to such obligations, on 26 April 2017, the Mexican government created the National Council of the 2030 Agenda for Sustainable Development (the National Council),[4] which is in charge of defining and coordinating the necessary mechanisms, policies and activities that Mexico must pursue for the fulfilment of the 2030 SDGs, identifying strengths and opportunities in connection therewith. But, even more importantly, this council is considered the main driver for lawmakers in Mexico to develop ESG policies, in the sense that the National Council is empowered to draft bills and propose amendments to Mexican legislation.

Furthermore, the National Council recognises the wide range of subjects that the pursuit of the SDGs represents, bringing together on its board 19 of the Mexican Federal Secretariats, seven non-sectored institutions, two autonomous agencies and the President of Mexico, who will lead the efforts of the council.[5] In addition to the creation of this council, it was necessary to modify laws to allow those parties to implement their work. Thus, on 16 February 2018, the Planning Law became the first law to be modified. Among other things, this amendment authorised the 2018–2024 and 2024–2030 Federal Administrations to adopt strategies to achieve the SDGs pursuant to proposals from the National Council.

In connection with the National Council efforts described above, a work plan and principal guidelines for the council are detailed in the 'National Strategy for the implementation of the 2030 Agenda in Mexico', released in November 2019, which identifies the following guiding tenets:

- increasing the investment for sustainable development;
- designing sector programmes promoting the 2030 Agenda;
- guiding state councils on the 2030 Agenda;
- assisting local legislatures on the creation of sustainable laws;
- consolidating work sessions of the National Council of the 2030 Agenda for Sustainable Development; and

4 1 DOF, 'Decreto de Creación del Consejo Nacional para la Agenda 2030', *Official Journal of the Federation (DOF)*, 26 April 2017.

5 DOF, 'Decreto por el que se reforma el diverso por el que se crea el Consejo Nacional de la Agenda 2030 para el Desarrollo Sostenible', *Official Journal of the Federation (DOF)*, 20 July 2021.

- maintaining focus on implementation in the municipalities.[6]

While the above listed tenets will certainly impact local and state laws, it is first necessary to review and assess the general and federal laws to determine whether Mexico's federal legal system is prepared to accept and adopt a sustainable model.

In 2020, the Legislative Strategy for the Agenda 2030 was published, drafted by the Mexican Chamber of Deputies, the President's Office and the German Agency for International Cooperation (GIZ) GmbH on behalf of the Federal Ministry for Economic Cooperation and Development (BMZ) of Germany, among other organisations, as a joint effort to assess and identify the main challenges and opportunities in aligning Mexican laws with the 2030 Agenda. As a result of this valuable research, the Mexican legal framework was carefully reviewed to identify the main areas of opportunity for the implementation of the SDGs and their objectives. Despite the areas of opportunity identified for each SDG, the assessment also provided recommendations that will help and guide lawmakers to follow the 2030 Agenda's guidelines and account for the protection of human rights – the main driver of SDGs.

Local and federal legislators have strived to adopt SDGs while drafting the laws that will rule Mexican society. It must be recognised with hindsight that Mexican laws must be updated to better align with current world struggles and to better address topics that concern all of us, such as ESG.

In parallel, as an additional measure to align national legislative efforts with the 2030 Agenda, the Mexican National Commission of the Retirement Savings System (CONSAR – the authority that regulates and supervises the Pension Saving System (SAR) and, in particular, the Retirement Funds Administrators (AFORE)) published the 'General provisions on financial matters related to Retirement Savings Systems' (the General Provisions) on 16 December 2018, in the Official Gazette. The General Provisions set forth that every finance risk committee of an AFORE must define, approve and promote, among other things, methodologies and measurement criteria addressing environmental, social and corporate governance factors for credit evaluation in addition to those already called for by the rating agencies. Although the General Provisions do not apply

6 DOF, 'Decreto por el que se reforma el diverso por el que se crea el Consejo Nacional de la Agenda 2030 para el Desarrollo Sostenible', *Official Journal of the Federation (DOF)*, 20 July 2021.

to the general population of Mexico, by targeting the AFOREs (which represent the main institutional Mexican investors), the General Provisions have caused the private sector to adopt ESG performance indicators on a voluntary basis.

The private sector perspective

As noted above, ESG legislative efforts in Mexico are still at an early stage. Further, it is the private sector that has started to apply internal ESG policies to comply with the international criteria that may be applicable to them, to attract financing and to compensate for the environmental and social impact that may result from their activities.

What actions are organisations and companies taking in the Mexican real estate sector?

AMEFIBRA

AMEFIBRA is the Mexican Association of Real Estate Investment Trusts (FIBRAs or REITs), created in 2015, which currently comprises and represents the 15 largest FIBRAs in Mexico in the retail, industrial and hotel sectors. One objective of AMEFIBRA is to establish best practices and uniform criteria among its members to standardise the information and reporting they share with the market.[7]

In 2020, AMEFIBRA published the Manual of Environmental, Social and Governance Indicators (the Manual) to guide its members and assist them in identifying the most relevant ESG metrics and indicators worldwide, aiming to standardise the use of such indicators and establish guidelines to report clear and standardised information to the market, cover institutional and private investors, rating agencies and index providers.[8]

As part of AMEFIBRA's analysis of ESG indicators for its members, the association selected 20 general indicators (the General Indicators), as well as specific indicators applicable only to certain sectors. Among the General Indicators are the following:

- establishing ESG objectives and action plans on an annual basis, recommending establishment of financial and non-financial incentives or accountability for managers or decision makers for achieving ESG KPIs;

7 https://amefibra.com/en/main/.
8 idem.

- aligning with ESG initiatives and reporting standards, such as the 17 SDGs and the 10 Principles of Global Compact, as well as adhering to reporting standards such as the Global Reporting Initiative (GRI), Integrated Reporting (IR), Carbon Disclosure Project (CDP) and the Principles for Responsible Investment (PRI);
- selecting, evaluating and managing suppliers and contractors, whereby the establishment of strict criteria and policies is recommended for the third-party selection process, as well as regular monitoring and auditing of such third parties;
- establishing ESG criteria in the due diligence process for new acquisitions, including, among other things, energy efficiency, sustainable materials, greenhouse gases (GHG) emissions and water efficiency; and
- identifying whether the real estate portfolio complies with specified building certifications.

Regarding specific indicators for certain sectors, the Manual recommends implementing the following indicators.

- Industrial: execute employee health and safety indicators; tenant satisfaction surveys and improvement programmes; sustainability performance management systems, such as ISO 14001 (environment), ISO 150001 (energy), ISO27001 (information security) and ISO 45001 (health and safety); and energy consumption monitoring.
- Education: including ESG-related covenants in lease agreements.
- Commercial and retail: implementing programmes to improve employee satisfaction; programmes to approach the community and tenants on sustainability issues; supply chain training and monitoring; and programmes to equip and refurbish facilities to meet ESG standards.
- Hospitality: executing employee health and wellness programmes, and monitoring employee health and safety indicators.

AMEFIBRA released its latest ESG Report in 2021, which logs the continuous progress made by the FIBRAs in relation to sustainability, with an executive summary of such milestones, as follows:

- the executive directors of the 15 FIBRAs comprising AMEFIBRA are members of the Sustainability and ESG Committee of AMEFIBRA;
- all 15 FIBRAs have established an ethics line to report any violation to their code of conduct, reporting any misconduct related to discrimination, harassment, anti-corruption, human rights, conflicts of interest and equity and inclusion;

- 13 FIBRAs have established social policies;
- 11 FIBRAs have established an ESG Committee (an increase of 36 per cent versus 2020);
- 10 FIBRAs have established an acquisition and construction strategy with ESG considerations, and 12 of them implement due diligence processes that include ESG criteria (an increase of 7 per cent and 40 per cent respectively versus 2020);
- 10 FIBRAs have established ESG annual objectives and goals (an increase of 10 per cent versus 2020);
- seven FIBRAs are reporting in accordance with the Sustainability Accounting Standards Board (SASB) and five FIBRAs have adopted Task Force on Climate-Related Financial Disclosures (TCFD) methodologies; and
- the percentage of women serving on committees of the FIBRAs increased by 4 per cent compared with 2020.

Fibra UNO

As a leader in the real estate sector, with 636 properties across all sectors, and now in the ESG industry, Fibra UNO has issued long-term sustainable bonds. In 2021, the company placed two senior unsecured sustainable bonds totalling 8.1 billion pesos.[9] Related to ESG, Fibra UNO reported having been listed for a second consecutive year in the S&P/BMV Total Mexico ESG Index, an index created by S&P Dow Jones Indices and the Mexican Stock Exchange to boost the performance of companies that meet the highest standards in Mexico on ESG criteria.[10] Fibra UNO is one of the 15 FIBRAs of AMEFIBRA.

FIBRA Prologis

FIBRA Prologis is a company focused on acquiring, owning and managing Class A Logistics and manufacturing real estate. At the end of 2021, its portfolio included 224 properties mainly focused on consumer-orientated markets. In 2021, FIBRA Prologis completed the issuance of a US$70 million green bond offering of long-term trust certificates and a US$300 million green US private placement of senior unsecured notes.[11] According to its latest 2021–2022 ESG

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9 https://funo.mx/site_media/uploads/documentos/data-XNt7XFVCQE.pdf.

10 https://funo.mx/site_media/uploads/documentos/documento-vOmDz-1657646364.pdf.

11 https://www.fibraprologis.com/en-US/news-events/press-releases/detail/363/fibra-prologis-refinances-us370-million-through-a-green.

report, FIBRA Prologis has been included in the S&P/BMV Total Mexico ESG Index and received Green Star recognition as the 2021 Industrial Overall Regional Sector Leader, among other qualifications.[12]

We expect that other large Mexican players in the real estate industry will continue issuing green and sustainability-linked bonds in the near term, following the path of the major players.

The corporate governance, social and environmental perspective

Environmental

Notwithstanding the efforts mentioned above, preparedness to comply with existing or potential environmental regulations is also key when it comes to real estate investment. Variables such as location and building structure, integrating green energy and incorporating a wastewater treatment facility or low-carbon technology into development plans will increase the value of a property and will make it more attractive not only to investors but also to tenants. Projects address environmental issues in various ways, including the following.

Climate change adaptation

Climate change may be the most pressing challenge we are currently facing, and its impact will also affect a building's operations and value. Physical risks caused by climate change include floods, wildfires, extreme heat, storms, steadily rising sea levels and changes in average temperatures. These impacts are causing changes in the economy, legislation and consumer behaviour, as well as the creation of technology focused on transition to clean energy, resulting in GHG reduction requirements and low-carbon alternatives.

Renewable energy and water conservation

Management of how limited resources are utilised, consumed and tracked will result in either an ESG risk or an opportunity that will affect real estate investments. Programmes that aim for better management of resources, such as of energy and water, may require higher investments upfront, but will eventually result in lower utility costs and, in the long term, may be more attractive investments for developers and tenants alike. With these indicators, location and property type will be relevant factors given that areas with extreme temperatures or experiencing water stress will become less attractive.

12 https://d1io3yog0oux5.cloudfront.net/_aad75323885257adeb668cfa9d97b8d4/fibraprologis/db/838/7737/pdf/MARKET-3427_2021+FIBRA+ESG+Report.pdf.

Compliance with environmental regulations

Environmental compliance affects many aspects of real estate investment. Compliance considerations influence the environmental impact caused by the operation of commercial and industrial buildings, and the resulting generation of hazardous and non-hazardous waste, air emissions and wastewater discharges. Compliance also serves to prioritise issues related to site selection, including removal of vegetation or change of forestry land use; the presence of endangered wildlife; and other factors that may result in additional environmental compliance obligations.

Projects that fail to prioritise these issues or that handle them poorly may face considerable delays, shutdowns, litigation costs or fines and penalties due to noncompliance, not to mention potential reputational damage that may be considerably higher and more difficult to estimate. To mitigate risks around environmental compliance, investors should conduct comprehensive due diligence to confirm the existence of environmental impact assessments, environmental site assessments (including Phase I and Phase II if needed) and any required change in forestry land use. While liability for maintaining environmental compliance and preventing ecological harm may ultimately fall mainly on the tenants or occupants of the properties, in Mexico, owners might end up inheriting these liabilities if they fail to proactively work with tenants to prevent incidents and limit potential remediation liabilities associated with a property, and thus its market value.

Management of tenant sustainability impacts

Further to the above, it is reasonable to assume that, to the extent that tenants have control over a property's consumption of resources, environmental impacts and health or social impacts on residents or the local population, real estate investors have the means to manage and minimise those impacts. Aside from potential liability associated with tenant activities that result in soil pollution, investors are also exposed to reputational risks associated with tenant conduct. To avoid this, owners have the ability to propose incentives or stipulate contractual obligations to prevent negative social, governmental and environmental impacts.

Social

As with many companies worldwide, Mexican companies have started to implement corporate social responsibility (CSR) standards. Many large Mexican companies incorporate CSR, as it has developed into an expectation and a demonstration of a company's economic, legal, ethical and philanthropic responsibilities.[13] In fact, the level of participation in CSR policies is often directly proportionate to the size of the company,[14] the most commonly used CSR model in Mexico being the 'socially responsible company'.

CSR is currently considered to add value to companies (though not a legal requirement) and has been used as a marketing tool by most companies to attract business and talent. However, the economic and reputational impacts of CSR have started to become apparent, especially for big enterprises.

Corporate governance

Given that Mexican corporate laws and regulations, except for the specific cases addressed in this chapter, do not obligate companies to include reporting methodologies or establish criteria to evaluate ESG compliance, companies are free to determine whether or not to report their ESG information. However, the CONSAR, by way of enforcing the General Provisions, has established itself as the main promotor of such standards. Additionally, since AFOREs are the main institutional investors in FIBRAs,[15] it has become possible (through the AFOREs) to influence other sectors of the Mexican economy to adopt ESG standards and methodologies that will allow employees and investors to make informed decisions on where to invest their money, taking ESG factors into account.

In addition, Mexican institutional investors, such as AFOREs, are not only adopting ESG criteria and methodologies, but are also adopting the Principles for Responsible Investment,[16] the United Nations-supported initiative that promotes sustainable investment utilising ESG factors.

Financing

From a more economic-centred perspective, how to finance projects and which projects to invest in has always been a concern for companies all around the world, especially during an economic crisis such as the one derived from the covid-19

13 Anonymous, 'The Value of Corporate Social Responsibility in Mexico', OLEAD 410: Leadership in a Global Context, 3 November 2020, https://sites.psu.edu/global/2020/11/03/the-value-of-corporate-social-responsibility-in-mexico/.

14 Fong Reynoso, Carlos et al., http://www2.udec.cl/~ran/ojs/index.php/ran/article/view/140.

15 Gonzalez, Verónica, 'Afores, aseguradoras, principales inversionistas de los Fibras', Real Estate Market & Lifestyle, 30 November 2021; https://realestatemarket.com.mx/noticias/capital-markets/35625-afores-aseguradoras-principales-inversionistas-de-los-fibras.

16 Santiago, Judith, 'Buscan que afores hagan inversiones sustentables', Periódico El Economista SA de CV, 11 February 2020, https://www.eleconomista.com.mx/mercados/Buscan-que-afores-hagan-inversiones-sustentables-20200211-0089.html.

pandemic. Nevertheless, because of the growing interest in ESG issues and an increasing interest in green projects, green bonds have emerged as one of the best candidates to help companies move financial resources toward clean and sustainable investments.[17] A green bond is a relatively new type of bond defined by the International Capital Markets Association (ICMA) as 'any type of bond instrument where the proceeds or an equivalent amount will be exclusively applied to finance or re-finance, in part or in full, new and/or existing eligible Green Projects'.[18]

Green bonds may be more financially expedient than non-green ones since they provide large advantages for corporate issuers and play a major role in greening the economy without corresponding financial loses.[19] In addition, certain eligible green projects may have social co-benefits. Bonds that intentionally mix eligible green and social projects, are referred to as 'sustainability bonds'.[20] Bonds issued for green, social or sustainable projects and objectives are referred to herein as 'labelled bonds'.

The labelled bond market most commonly supports green projects, including assets, investments and other related and supporting expenditures such as research and development that may relate to more than one category or environmental objective. Among the most eligible green projects categories are:

- renewable energy;
- energy efficiency;
- pollution prevention and control;
- environmental sustainable management of living natural resources and land use; and
- green buildings.[21]

The evolution of this market over the years confirms the great potential of this financial instrument. Since 2007, when the European Investment Bank (EIB) first issued a green bond, the market has been growing and becoming more sophisticated. In Mexico, labelled bonds (green, social and sustainable) have financed

17 Gianfrat, Gianfranco & Peri, Mattia, 'The Green advantage: Exploring the convenience of issuing green bonds', Journal of Cleaner Production Vol. 219, 2019, pp. 127–135, https://doi.org/10.1016/j.jclepro.2019.02.022.

18 International Capital Market Association, 'Green Bond Principles', June 2021 (with June 2022 Appendix 1), p.3.

19 idem.

20 idem.

21 idem.

green projects in sectors including renewable energy, sustainable infrastructure, clean energy, energy efficiency, basic infrastructure and sustainable construction. These bonds have tenures from 3 to 15 years and offer interest rates between 3.04 per cent and 10.81 per cent.[22]

Considering the financial benefits of issuing green bonds versus conventional bonds, there is a statistically significant advantage for issuers when a bond is labelled as being green, social or sustainable. This advantage is quantifiable on account of lower interest paid annually, on average, to investors. Moreover, this advantage is realised by both companies and non-corporate entities, such as municipalities and government agencies. Even taking into account the additional costs required to obtain a green certification, labelled bonds are relatively more beneficial for issuers. Thus, labelled bonds are potentially advantageous not only for society, but also for issuers, as they can materially reduce the cost of debt financing.[23]

Green bond issuance is one indicator of a company's inclination to make environmentally friendly investments and improve its ESG profile. Issuers' share prices increase significantly upon the announcement of a green bond issuance. Green bonds can help enlarge a company's investor base because green bond issuances can attract more media exposure and can be used by impact investors to satisfy their investment mandates. In addition, green projects associated with positive future cash flow can help companies survive over the long term. Overall, the results suggest that existing shareholders derive material net benefits from green bond issuances.

In all, green bond issuers can benefit from a lower cost of capital and, therefore, the stock market reacts positively to the announcement of green bonds.[24]

Challenges

As noted above, green projects and the green bond market are not new concepts in Mexico. Indeed, the first Mexican green bond was issued by Nacional Financiera (the Mexican Development Bank) in 2015 – the first issuance of a green bond by

22 idem.

23 Gianfrat, Gianfranco & Peri, Mattia, Op Cit, p.128.

24 Yongjun Tang, Dragon and Zhang Yupu, 'Do shareholders benefit from green bonds?', *Journal of Corporate Finance* Vol. 61, 2020, 101427, https://doi.org/10.1016/j.jcorpfin.2018.12.001. A basic measure of the benefit of Green Bond pricing is the yield spread at the time of issuance.

a development bank in Latin America. After this, the Mexican Stock Exchange recognised these instruments as viable financing options for the private sector and green bond options have continued to grow.

In 2021 alone, 39 new bonds with a sustainable or social focus were issued in Mexico for a total value of MX$181.77 million.[25]

This is three times larger than in 2020, according to available public information. Despite certain optimistic voices, the worldwide covid-19 pandemic has made it difficult to objectively determine where we stand and how ESG and green or labelled bonds are going to develop in the near future, notwithstanding the abovementioned financial benefits.

Notwithstanding the noticeable efforts described in this chapter, ESG is unfortunately not yet a priority in the overall Mexican market and is not yet considered by the majority of companies to be a key consideration for projects. It is no surprise that the attention of the majority of Mexican companies turns to other more 'urgent' matters and short-term concerns, such as profitability, productivity, bureaucratic red tape and the ever-present challenges of corruption and insecurity. As a result, even with the visible worldwide trend to promote ESG through regulation, and a growing interest by investors, lenders and companies in implementing ESG policies, these considerations are still secondary in countries like Mexico.

Even with some investors, associations, FIBRAs and companies putting ESG on their agenda, currently there is nothing that will legally force a company to apply ESG policies right away and make them a business priority. Fortunately, public policies such as the General Provisions, are introducing better terms for financing projects that incorporate ESG principles (i.e., green bonds and labelled bonds) and promoting an increased awareness among current and coming generations of concerns about the health of the planet. As a consequence, green financing and ESG principles will likely move into the spotlight over time in Mexico.

These optimistic trends bring challenges. In a country where ESG has not been sufficiently encouraged through regulation and green financing has not yet found a common criterion, it is difficult for investors to choose where to invest and which projects are suitable for their impact investment needs. Further, there is uncertainty on how investors can be reassured that their impact investment goals

25 Coldwell Banker Commercial México, 'Enfoque verde, esencial en la atracción de nuevas inversiones', 9 March 2022, https://cbcmexico.mx/detalle_blog/75/Enfoque-verde-esencial-en-la-atraccion-de-nuevas-inversiones.

are being met. There is still a long way to go in terms of public policy. Should the Mexican market follow the LEED rating system, follow the guidelines of MSCI, Inc,[26] or push to improve the General Provisions? What system is most suitable for Mexico, its economic situation, social environment and related challenges?

Better generally accepted local measurement standards applicable to qualifying for green financing or to being certified as an ESG-compliant company are a critical requirement in Mexico, so as to guarantee the accurate assessment of the impact of green financing projects and ESG-compliant projects, and to account for their environmental and social impact. Currently, the General Provisions only make recommendations regarding the criteria to be applied to green bonds. No domestic authority is generally accepted in today's market as the certifying entity or agency for ESG projects or companies, with the resources to measure the local social benefits or green impacts of the projects that are being financed.

The lack of clear criteria for certifications and applicable legislation in Mexico could result in misleading credentials and the risk of greenwashing projects to access undeserved benefits, negatively affecting those projects with a real ESG commitment.

What is coming?

As ESG gains in popularity, our goal must be to permanently embed ESG in projects, corporate policies and legislation. ESG and sustainability must become part of the general corporate and social culture – a key item to be implemented by law-making bodies and law-abiding agencies. The first steps in creating legal obligations related to ESG and sustainability can already be seen in certain technical rules (i.e., the Official Mexican Standards), but the larger picture will be driven by investors and companies. A general consensus is developing that 'reporting on the presence of ESG criteria results in a greater benefit, both in terms of the economic return received by companies and the clear impact on the planet and society'.[27] As noted above, these criteria have yet to become commonplace across the public sector and in company policies. To make progress, it is clear that private and public sector actors must work together to develop a long-term strategy, consistent with the ESG framework, to address the challenges currently faced by Latin America and Mexico. Positive steps related to ESG financing are being taken by Mexico, such as the market for green bonds and sustainability

26 See www.msci.com.

27 Auxadi, 'ESG: Latin America facing the challenge of responsible investment', 9 February 2021, https://www.auxadi.com/es/news/esg-latam-inversion-responsable/.

bonds. In addition to green bonds in Europe, Mexico has issued bonds in the yen market, becoming the first country in Latin America to place sustainability bonds in Japan. Hopefully these actions will continue, establishing Mexico as a pioneer and an innovative country in these instruments.

Another more economic consideration that should be an incentive towards the integration of ESG considerations in Mexico and Latin America is the potential shift of North American supply chains from Eastern countries like China to locations in the western hemisphere. In view of the current status of the commercial relationship between China and the United States, a new, more serious, discussion is being raised regarding how nearshoring could become a promising source of investment, jobs and growth for Mexico. Such investments could present an unprecedented opportunity to consolidate much-needed growth in the region and attract foreign investors willing to engage in ESG-driven investing. This reality is rapidly approaching, and if local participants are unprepared or unaware of the implications, economic opportunities could be lost and an important chance to positively impact and improve our environment and society could be wasted.

In conclusion, there is a long way to go, and although there are more and more players (investors, funds, developers, end-users) that now participate actively in ESG, sustainability and green financing, there is still much to regulate and many standards to be implemented in order to measure and provide certainty to investors who are seeking to make a real social, corporate and environmental impact through their projects in Mexico.

APPENDIX 1

About the Authors

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Diego Gómez-Haro has almost 20 years of experience serving as lead or local counsel, advising a broad range of clients, including private equity funds, financial institutions, venture capital firms, corporate clients and family offices in domestic and international transactions in Mexico.

He has substantial experience in mergers and acquisitions, corporate and real estate transactions, including structuring of investment vehicles, asset and stock acquisition and disposition, project development and financing, including commercial financing, acquisition financings and real estate financing. Additionally, he advises international companies on structuring their entry or investments in Mexico, including all aspects of corporate law.

Diego has led cross-border transactions, advising large multinationals and private equity investors and sponsors on acquisitions and investments in Mexico across multiple industries.

Prior to joining Sánchez Devanny, Diego acted as general counsel of The Blackstone Group in Mexico, as well as in top-tier law firms in Mexico, advising domestic and multinational companies in mergers and acquisitions, banking and finance, debt and corporate restructuring, capital markets and general corporate matters.

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José Miguel Ortiz is a trilingual lawyer with more than 10 years of national and international experience in top-ranked law firms, advising domestic and foreign clients, buyers, sellers and financial advisers in acquisitions of financial entities and private companies, specialising in various sectors. Additionally, he has participated in corporate restructurings and bankruptcy proceedings, advising creditors and as part of the conciliator's team in the housing, construction and mining sectors.

José Miguel also specialises in antitrust, assisting domestic and foreign companies in merger control processes, and in obtaining prior approval from the Federal Economic Competition Commission in verification proceedings before such commission, including investigations of monopolistic practices, and in obtaining favourable opinions in bids processes and cross participation (with emphasis on the real estate, energy, infrastructure, natural gas, education and financial services sectors).

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Oscar has practised law for more than 10 years. He specialises in corporate law and regulatory compliance.

Oscar currently advises Mexican and non-Mexican companies on their corporate formations and start of operations in Mexico; corporate restructurings; mergers and acquisitions; corporate governance; public tender procedures; commercial contracts; and corporate law. Likewise, Oscar has vast experience advising companies on compliance, anti-corruption and anti-money laundering matters, including leading critical internal investigations.

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Claudia joined Sánchez Devanny in 2017. She is a specialist with more than 12 years of experience in environmental matters with a focus on water management, environmental impact and integrated waste management. Claudia has training in sustainable development and corporate social responsibility.

Prior to joining Sánchez Devanny, Claudia was in charge of the sustainable development department of AlEn Industries, coordinating the company's corporate social responsibility strategy and designing policies to meet goals for reduction of water consumption and waste generation, increase plastics recycling, sustainable use of natural resources through commercial plantations, among others. While leading the environmental legal department for Cerveceria Cuahutemoc Moctezuma, she implemented and carried out evaluations on environmental compliance in the Productive Plants, Federal Zone and National Water Concession Titles. She has extensive experience in the design and administration of environmental compliance tools, employee training programmes and the creation of policies for hiring environmental service providers. She has advised clients in administrative proceedings before the Federal Attorney for Environmental Protection and various state environmental authorities.

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Franco is a lawyer in Sánchez Devanny's corporate and transactional practice, specialising in anti-corruption and regulatory law. Franco advises the firm's clients on compliance with obligations before local authorities regarding licences, permits and authorisations that apply to their business units, such as retail and industry, in accordance with the complex Mexican legislation, federal, state and municipal.

Through Franco's advice to industrial and retail clients, they align their operations to the highest standards of regulatory compliance, having under their coordination more than 150 establishments regarding licences and permits, addressing the challenges of dealing with government agencies. Throughout his professional experience, he has advised on a wide range of subjects, such as land use, construction, environment, right of way (road and rail), advertising, operating licences, alcohol sale/consumption permits, authorisations and permits for special events and commercial campaigns, such as 'El Buen Fin', Christmas Season, grand openings of new commercial establishments, and massive concentration events.

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Published by Latin Lawyer and LACCA, edited by Antonia Stolper and Robert O'Leary, partners at Shearman & Sterling LLP, *The Guide to Environmental, Social and Corporate Governance* will benefit all practitioners acting in Latin America's fast-moving ESG landscape. This guide draws on the expertise of highly sophisticated practitioners to provide an overview of the main elements of ESG affecting the region's businesses and markets. Its aim is to be a valuable resource for business people, investors and their advisers as they embark on their ESG journey.

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