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## Environmental Performance and the Cost of Capital: Evidence from Commercial Mortgages and REIT Bonds

43 Pages

Posted: 13 Jan 2016

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John Molson School of Business, Concordia University

Date Written: December 25, 2015

### Abstract

There is an ongoing debate about the impact of environmental performance on a firm's cost of capital, but most academic studies are hindered by methodological challenges. The real estate sector, which is at the nexus of many environmental and energy issues, offers a laboratory to address the relationship in a direct manner. Using a sample of U.S. REITs, we investigate the spreads on commercial mortgages collateralized by real assets, some of which are environmentally certified. We also study spreads on corporate debt, both at issuance and while trading in the secondary market. The results show that environmentally certified buildings command significantly lower spreads as compared to conventional, but otherwise comparable buildings. The spread difference varies between 35 and 36 basis points, depending on the specification. At the corporate level, we document that REITs with a higher fraction of environmentally certified buildings are able to issue bonds at lower spreads, after controlling for a broad set of REIT and bond characteristics. A difference-in-difference analysis of bond spreads in the secondary market corroborates this finding. The results in this paper provide some evidence that the financial market capitalizes the environmental performance of collateral into the pricing of financial products.

**Keywords:** Environmental performance, commercial mortgage valuation, corporate bonds, commercial real estate, real estate investment trusts (REITs)**JEL Classification:** G51, M14, D92[Suggested Citation](#) >[Show Contact Information](#) >[Download This Paper \(Delivery.cfm/SSRN\\_ID2714317\\_code1543346.pdf?abstractid=2714317&mirid=1\)](https://papers.ssrn.com/sol3/Delivery.cfm/SSRN_ID2714317_code1543346.pdf?abstractid=2714317&mirid=1)[Open PDF in Browser \(Delivery.cfm/SSRN\\_ID2714317\\_code1543346.pdf?abstractid=2714317&mirid=1&type=2\)](https://papers.ssrn.com/sol3/Delivery.cfm/SSRN_ID2714317_code1543346.pdf?abstractid=2714317&mirid=1&type=2)

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