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COMMENTARY

The value of embracing ESG for Reits

'Doing the right things and doing the thing right' will be key for organisations to commit to sustainability goals. BY CHEW TUAN CHIONG AND SING TIEN FOO

THE framework on environmental, social, and governance (ESG) has become a norm in the corporate world today, requiring firms to inform stakeholders on how they embrace sustainability in their business practices and operations. The investor community increasingly goes beyond narrow financial goals by adopting a broader set of ESG objectives in investment screening.

ESG is not just "the right thing to do" for firms; firms that have not adopted the ESG framework may lose out in terms of opportunities and potentially face the risk of being discriminated against and abandoned by society.

Heeding the recommendation of the Taskforce on Climate-related Financial Disclosures (TCFD), the Singapore Exchange (SGX) has introduced a phased approach to mandatory sustainability reporting starting in 2022. This requires firms to disclose non-financial information on ESG alongside financial disclosure and make the information publicly available to stakeholders.

However, embarking on the journey of ESG reporting is challenging. Many firms are still new to collecting, reporting, and disclosing climate-related data and information.

Companies should be clear of the raison d'etre for their ESG initiatives and emphasise a few that will create real impact instead of attempting to be too all-encompassing. They may otherwise risk being trapped in a "greenwashing" situation, where they over-promise and under-deliver in their ESG goals.

Real estate investment trusts (Reits) are among the largest real estate owners holding an extensive portfolio of physical buildings, which are the primary source of carbon dioxide emitters, contributing to nearly 40 per cent of global greenhouse gas emissions, according to the World Economic Forum.

Reits rely significantly on institutional investors, many of whom have an assertive posture on preference for ESG-conscious Reits. Therefore, Reits will have responsibilities and opportunities to reduce carbon emissions and improve ESG – they are in a good position to get things right.

Sustainability reporting

Climate-related reporting schemes are relatively new and still evolving.

The SGX prescribes the globally-recognised guidelines recommended by TCFD to help firms integrate climate-related risks and opportunities into business and investment decisions.

However, consistent and comparable standards have yet to be developed. The fragmentation and diversion in the reporting information by firms make it harder for investors to accurately benchmark and compare the ESG quality of firms.

In response to growing demands for a global framework to reduce variations and differences in ESG reporting, the International Financial Reporting Standards, a not-for-profit foundation setting the globally accepted accounting standards, created the International Standards Sustainability Board (ISSB) in 2021.

The ISSB is a new standard-setting board that establishes a comprehensive and consistent global baseline to allow businesses to build public trust through greater sustainability transparency.

Notwithstanding differences in scope and motivations of ESG strategies, firms should share information from both the "inside-out" views of conservation (waste not, want not, save the whale, preserve nature, etc) to the "outside-in" views on climate change risks.

Understanding the science in ESG

Poor governance could result in profit impairment very quickly, while poor behaviour with the community and stakeholders including staff (which comes under "social" in ESG) could also have short- and medium-term repercussions. Hence, "S" and "G" have been part of corporate mindshare for a long time.

"E", which refers to the environment, is relatively new – but climate inactions could have drastic long-term consequences. Businesses that respond to these calls for action recognise that a business case is frequently negative, and desired outcomes may take generations to manifest. In other words, there could be altruistic corporate social responsibility (CSR).

There is comparatively more incentive for companies to take action for "S" and "G". When there is a tangible boost to the bottom line, for example, reducing corruption or taking good care of the community, the decision is easy.

The global trend has been to combine many of the intangible attributes of "E" in a business into one single ESG standard and score. Therefore, it is worthwhile to discuss how Reit could tackle the "E" in its ESG journey.

For Reits holding geographically diversified properties, collection, reporting, and comparison of ESG data across regions are complex and may also be fraught with uncertainty. For example, the electrical energy use per square foot for Singapore buildings is likely to be much higher than that in Australia. This is because the humid tropical climate buildings here require air conditioning all year round, whereas in temperate regions, maintaining indoor comfort conditions entail far less energy.

But if one delves deeper, electricity in Singapore is mainly generated by the combustion of natural gas, which produces far less carbon dioxide than the ubiquitous coal-fired generation in Australia, so the impact on global warming will also be reduced. Similarly, Switzerland generates almost all of its electricity through hydro and nuclear with zero carbon dioxide emissions, and should be far less concerned about electricity consumption in buildings.

In the burgeoning ecosystem of sustainability reporting, there is a need for a deeper understanding of the science underpinning many actionable items in the checklist. Collective action will lead to positive results, but only if they are based on solid science.

How many chief executives, financial advisers, and accountants have stopped asking why carbon dioxide, constituting less than 1 per cent of the earth's atmosphere, can dramatically influence our climate. What makes it so unique? Are there other greenhouse gases? What is causing sea levels to rise so quickly as to threaten many islands and coastal regions – thermal expansion of water or melting ice-caps?

Why do some food and beverage outlets discontinue the use of plastic drinking straws but paradoxically continue to provide disposable plastic utensils?

In 1987, many nations signed the Montreal Protocol to phase out chlorofluorocarbons, coolants used in refrigeration systems, which have created a hole that was widening in the earth's ozone layer above the South Pole and then the North Pole. If the ozone hole continued to grow, more harmful ultraviolet radiation from the sun could have caused more skin cancers. The Montreal conference (and subsequently the broader Rio Declaration in 1992) helped to shine the spotlight on the fact that all is not well with the earth's health. Thirty-five years later, the ozone layer appears to have been "healed", vindicating the scientists and the science.

Sustainability reporting could go one step further to educate and create peer pressure to nudge everyone to do their part conscientiously and responsibly. The collective effort could go a long way to help reduce greenhouse gas emissions.

Greenwashing

Many Singapore Reits have embraced ESG to different extents. The ecosystem is thriving, bringing together regulators, advisors, consultants, and even assurance professionals, as well as technical and engineering professionals, to enhance a building's "green-ness" not just at the design stage but also subsequently retrofitting and operations. With the advent of sustainable-linked financings, such as green loans and bonds, ESG performance is now a determinant in fundraising for companies beyond the share price.

Some Reits produce an ESG sustainability report that is more voluminous than their annual report. The former covers a wide range of issues from energy use intensity to human talent engagement, stakeholder surveys, incidents of fraud, health and safety incidents, and past data and future ESG targets, just to name a few.

Reit stakeholders and investors are overwhelmed by universal data that fill up the space in the report, resulting in information asymmetries. There is a risk that some truly pertinent data will get submerged or distorted. They should walk the talk to avoid over-promising and under-delivering in their green pledges.

Firms that use their volunteer endorsements of the United Nations Global Compact as a marketing spin to improve public perception may face the backlash of "blue-washing" if they fail to introduce changes and reforms to act socially and responsibly to improve the environment. Reits need not be overly ambitious in wanting to save the earth. Still, they can do better by clarifying and prioritising their actions to produce concrete outcomes, over and above securing the desired labels of being strong ESG entities.

One way to remove information asymmetries is to signal ESG quality via third-party or independent assessment agencies. Real estate operators can subject themselves or their asset portfolios to assessments that yield a sustainability score, which can then be benchmarked against industry peers worldwide.

GRESB, formerly known as the Global Real Estate Sustainability Benchmark, is an independent organisation set up in 2019 to validate ESG performance and sustainability best practices for real estate and infrastructure funds, companies, and assets worldwide.

The Greenmark Certification Scheme by Singapore's Building Construction Authority provides green certifications for new and existing buildings based on climatic responsive design, building energy performance, health and wellness, and other criteria. Other international rating schemes include Leadership in Energy & Environmental Design and Energy Star in the US, Building Research Establishment's (BRE) Environmental Assessment Method in the UK, Beam Plus (Building Environmental Assessment Method) in Hong Kong, Green Star in Australia, and the Comprehensive Assessment System for Built Environment Efficiency in Japan, among others.

Current misgivings about greenwashing will likely lead to a more critical investor base. It is worthwhile for Reits to drill down to what they could have genuinely contributed to saving the earth in the long run, instead of trying to maximise their balanced scorecard in selected core ESG metrics.

The beauty of carbon sequestration is that we all share the same atmosphere. Removing carbon dioxide anywhere on the planet benefits all who need to continue living on it. It will be more beneficial to support a verifiable ecological initiative that propagates a big mangrove farm in some remote islands in the Pacific. The latter act is akin to adding a carbon sink. Again, informed decision-making based on science will distinguish between true impact and fatuous actions.

Lastly, with Singapore's commitment to carbon neutrality by 2050, and many real estate owners projecting a similarly aggressive timeline, carbon credits will inevitably come into play.

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