Talking Points

Adding ESG Transparency to Real Estate

More and more investors are integrating ESG risks into their investment process. Given the large size and specialized nature of real estate assets, the investment community has demanded sophisticated tools to more accurately identify real estate companies that own more sustainable properties and integrate this information seamlessly into their investment process.

S&P Dow Jones Indices has collaborated with GRESB, a leader in evaluating ESG characteristics of real estate companies, to create the Dow Jones Green Real Estate Indices. The indices, which utilize data from GRESB, are designed to be representative of the investment characteristics of conventional real estate benchmarks, but with an improved sustainability profile.

Index Offering

- Dow Jones Global Select Green RESI
- Dow Jones U.S. Select Green REIT Index
- Dow Jones Global Ex-U.S. Select Green RESI

1. Why do real estate companies require a specialized approach to quantifying sustainability?

Dan: While sustainability considerations affect all industries, they are particularly relevant for the real estate sector. With an estimated 40% of all global carbon emissions being driven by the construction and operation of buildings, real estate is a particular industry of focus among institutional investors. Buildings are long-lived and typically cannot be moved to another place, which leaves them exposed to the direct localized consequences posed by sustainability risks: more stringent regulatory requirements; changing societal preferences for places to work, live, and play; and exposure to climate-related events such as flooding, water scarcity, and extreme weather conditions.

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There’s a growing recognition by companies and investors that ESG matters are fundamental to business performance and should be disclosed in financial reports. Businesses are also coming to realize that integrating ESG concerns into core business and financial decisions will generate new streams of data that can be used to enhance growth and sustainability.

Real estate is a complex business with varying degrees of control on construction quality and operational excellence. The GRESB framework is specifically tailored to real estate companies that seek to embrace industry best practices on the full range of ESG issues that can be material to shareholders.

2. Why do investors have an appetite for gauging the ESG performance of real estate companies?

Mike: It is estimated that nearly 40% of global carbon emissions are driven by the construction and operation of buildings. Therefore, commercial property owners clearly face material risks from climate change and potential future costs to reduce carbon emissions and other related environmental impacts. Given the challenges associated with measuring property-level sustainability and then aggregating individual properties to the corporate real estate investment trust (REIT) level, real estate investors have historically lacked high-quality and efficient tools to integrate ESG risks into their investment strategies. These indices are designed to close that gap.

Dan: Concerns about ESG risks are increasingly critical to long-term investment outcomes. Investors need useful information on how real estate companies are navigating issues such as climate change, energy price volatility, water scarcity, changes in environmental legislation, evolving customer demands, and increasingly stringent governance requirements in order to make decisions.

Integrating these ESG considerations into investment processes can drive positive results via active engagement techniques designed to improve sustainability performance, by implementing positive company screening strategies, or when deploying thematic investment mandates. Empirical studies and a wealth of academic research have repeatedly demonstrated economically meaningful effects that result from the widespread diffusion of ESG data.

Although leading real estate companies work to actively manage ESG-related issues, including climate resilience and low-carbon economy transition risks, there remains a wide difference between global leaders and standard business practice. Investors continue to drive capital market demand for high-quality ESG performance data that help inform portfolio risks and improvement opportunities.

3. How do these indices work?

Mike: The indices consist of all companies included in the conventional Dow Jones Select Real Estate Securities Index (RESI) except for those deemed non-compliant with the UNGC principles and those identified by S&P Global’s Media & Stakeholder Analysis as involved in an ESG controversy. Constituent weights are then adjusted based on sustainability performance as measured by GRESB’s Total Score. More specifically, all companies are segmented into region and REIT subsector buckets, with weights tilted within these buckets so as to retain the region and sector weights of the conventional benchmark index.
4. Why did you construct the indices in this way?

Mike: In the ESG space, we have generally found demand to be greatest for index solutions that improve overall sustainability characteristics without introducing significant biases along geographic or sector lines. The Dow Jones Green Real Estate Indices are designed to meet this need by retaining similar investment characteristics relative to conventional real estate benchmarks. The country and sector composition of the indices remains similar, which has historically led to relatively low tracking error to the benchmark Dow Jones Select RESI.

5. What are the most important elements affecting a company's ESG performance and how do the indices capture that?

Dan: GRESB evaluates performance against 14 sustainability aspects, using over 50 indicators. The indicators follow a plan-do-check-act logic and are designed to encompass the actions and attributes of a wide variety of real estate companies and REITs included in the benchmark. The assessment includes information on performance indicators, such as energy consumption, GHG emissions, water consumption, and waste.

The methodology is consistent across different regions, investment vehicles, and property types and aligns with international reporting frameworks, such as GRI, PRI, and SASB. The data are subjected to a multi-layer validation process, resulting in high-quality data that investors and participants can use in their investment and decision-making processes.

Based on the assessment, GRESB provides an overall GRESB Score and GRESB Rating for each participant, as well as peer group comparisons that take into account country, region, and sector.

Generalized targets and well-intentioned corporate policies require an integrated action plan across multiple disciplines, or they risk falling short. The key to success is access to reliable data. Real estate companies that establish and track a full range of ESG metrics achieve multiple tangible business outcomes for shareholders.

6. How do S&P DJI's and GRESB's capabilities complement each other to make these indices effective market gauges?

Mike: S&P DJI has a long history of creating innovative benchmarks across multiple asset classes and investment categories. The real estate and ESG spaces are no exception. The Dow Jones Select RESI was introduced in 1991, and the Dow Jones Sustainability Index represented the world's first ESG index when it was launched in 1999. We are excited to be able to partner with GRESB in order to bring this new index series to the investment community.

Dan: The GRESB framework has over a decade of industry input by leading institutional investors, real estate companies, REITs, academic advisors, and capital providers from around the world. GRESB provides standardized and validated ESG data to increase capital market transparency. With a governance structure that assures a by-industry, for-industry approach, GRESB is able to elevate global ESG best practices in the real asset sector. Benchmarking core corporate attributes alongside ESG performance metrics provides investors with insights not previously available.
7. How are the indices unique in the market?

Mike: The Dow Jones Green Real Estate Indices utilize real underlying property-level data as reported via the GRESB real estate assessment and are built from a widely used conventional real estate benchmark. Other real-estate-focused ESG index offerings either use generalized ESG assessments that are not specific to real estate companies, use modeled data to estimate exposures, or are not built from an established underlying real estate benchmark. Additionally, we have rolled out a complete global index along with key regional subsets in order to offer a more comprehensive index series—something not available today in the market.

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