

TalkingPoints

Adding ESG Transparency to Real Estate



Michael Orzano, CFA
Senior Director
Global Equity Indices
S&P Dow Jones Indices

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.



Dan Winters, CRE
Head of Americas
GRESB

Index Offering

<u>Dow Jones Global Select ESG RESI</u>
<u>Dow Jones U.S. Select ESG REIT Index</u>
<u>Dow Jones Global Ex-U.S. Select ESG RESI</u>

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.¹ 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.

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. TheGRESB 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.¹ 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 byGRESB'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.

¹Source: U.N. Environment 2019 Global Status Report for Buildings and Construction Towards a zero-emissions, efficient and resilient buildings and construction sector. https://iea.blob.core.windows.net/assets/3da9daf9-ef75-4a37-b3da-a09224e299dc/2019_Global_Status_Report_for_Buildings_and_Construction.pdf

General Disclaimer

© 2022 S&P Dow Jones Indices. All rights reserved. S&P, S&P 500, SPX, SPY, The 500, US500, US 30, S&P 100, S&P COMPOSITE 1500, S&P 400, S&P MIDCAP 400, S&P 600, S&P SMALLCAP 600, S&P GIVI, GLOBAL TITANS, DIVIDEND ARISTOCRATS, Select Sector, S&P MAESTRO, S&P PRISM, S&P STRIDE, GICS, SPIVA, SPDR, INDEXOLOGY, iTraxx, iBoxx, ABX, ADBI, CDX, CMBX, MBX, MCDX, PRIMEX, HHPI and SOVX are trademarks of S&P Global, Inc. ("S&P Global") or its affiliates. DOW JONES, DJIA, THE DOW and DOW JONES INDUSTRIAL AVERAGE are trademarks of Dow Jones Trademark Holdings LLC ("Dow Jones"). These trademarks together with others have been licensed to S&P Dow Jones Indices LLC. Redistribution or reproduction in whole or in part are prohibited without written permission of S&P Dow Jones Indices LLC. This document does not constitute an offer of services in jurisdictions where S&P Dow Jones Indices LLC, S&P Global, Dow Jones or their respective affiliates (collectively "S&P Dow Jones Indices") do not have the necessary licenses. Except for certain custom index calculation services, all information provided by S&P Dow Jones Indices is impersonal and not tailored to the needs of any person, entity or group of persons. S&P Dow Jones Indices receives compensation in connection with licensing its indices to third parties and providing custom calculation services. Past performance of an index is not an indication or guarantee of future results.

It is not possible to invest directly in an index. Exposure to an asset class represented by an index may be available through investable instruments based on that index. S&P Dow Jones Indices does not sponsor, endorse, sell, promote or manage any investment fund or other investment vehicle that is offered by third parties and that seeks to provide an investment return based on the performance of any index. S&P Dow Jones Indices makes no assurance that investment products based on the index will accurately track index performance or provide positive investment returns. S&P Dow Jones Indices LLC is not an investment advisor, and S&P Dow Jones Indices makes no representation regarding the advisability of investing in any such investment fund or other investment vehicle. A decision to invest in any such investment fund or other investment vehicle should not be made in reliance on any of the statements set forth in this document. S&P Dow Jones Indices is not an investment adviser, commodity trading advisor, commodity pool operator, broker dealer, fiduciary, promoter" (as defined in the Investment Company Act of 1940, as amended), "expert" as enumerated within 15 U.S.C. § 77k(a) or tax advisor. Inclusion of a security, commodity, crypto currency or other asset within an index is not a recommendation by S&P Dow Jones Indices to buy, sell, or hold such security, commodity, crypto currency or other asset, nor is it considered to be investment advice or commodity trading advice.

These materials have been prepared solely for informational purposes based upon information generally available to the public and from sources believed to be reliable. No content contained in these materials (including index data, ratings, credit-related analyses and data, research, valuations, model, software or other application or output therefrom) or any part thereof ("Content") may be modified, reverse-engineered, reproduced or distributed in any form or by any means, or stored in a database or retrieval system, without the prior written permission of S&P Dow Jones Indices. The Content shall not be used for any unlawful or unauthorized purposes. S&P Dow Jones Indices and its third-party data providers and licensors (collectively "S&P Dow Jones Indices Parties") do not guarantee the accuracy, completeness, timeliness or availability of the Content. S&P Dow Jones Indices Parties are not responsible for any errors or omissions, regardless of the cause, for the results obtained from the use of the Content. THE CONTENT IS PROVIDED ON AN "AS IS" BASIS. S&P DOW JONES INDICES PARTIES DISCLAIM ANY AND ALL EXPRESS OR IMPLIED WARRANTIES, INCLUDING, BUT NOT LIMITED TO, ANY WARRANTIES OF MERCHANTABILITY OR FITNESS FOR A PARTICULAR PURPOSE OR USE, FREEDOM FROM BUGS, SOFTWARE ERRORS OR DEFECTS, THAT THE CONTENT'S FUNCTIONING WILL BE UNINTERRUPTED OR THAT THE CONTENT WILL OPERATE WITH ANY SOFTWARE OR HARDWARE CONFIGURATION. In no event shall S&P Dow Jones Indices Parties be liable to any party for any direct, indirect, incidental, exemplary, compensatory, punitive, special or consequential damages, costs, expenses, legal fees, or losses (including, without limitation, lost income or lost profits and opportunity costs) in connection with any use of the Content even if advised of the possibility of such damages.

S&P Global keeps certain activities of its various divisions and business units separate from each other in order to preserve the independence and objectivity of their respective activities. As a result, certain divisions and business units of S&P Global may have information that is not available to other business units. S&P Global has established policies and procedures to maintain the confidentiality of certain non-public information received in connection with each analytical process.

In addition, S&P Dow Jones Indices provides a wide range of services to, or relating to, many organizations, including issuers of securities, investment advisers, broker-dealers, investment banks, other financial institutions and financial intermediaries, and accordingly may receive fees or other economic benefits from those organizations, including organizations whose securities or services they may recommend, rate, include in model portfolios, evaluate or otherwise address.