Building a Robust ESG Disclosure Policy for REITS

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GROWING IMPORTANCE OF ESG

Money managers consider a variety of factors when underwriting an investment. In addition to traditional industry, strategic, corporate and financial factors, Environmental, Social, and Governance (ESG) considerations are gaining in prominence. This increased focus on ESG is being driven by the broader institutional investment community, as portfolio managers across the spectrum are being asked to score their own funds on ESG attributes, and justify their holdings with rigorous data. This focus is having an impact on corporations, and in August 2019, the Business Roundtable released a Statement on the Purpose of the Corporation, signed by 181 CEOs, who committed to lead their companies for the benefit of all stakeholders – customers, employees, suppliers, communities and shareholders – not primarily in the interest of shareholders.

Also — it is just good business. A growing body of research suggests that good corporate citizenship translates into better cash flow, better valuations, and better shareholder returns. According to research by Deutsche Bank, which evaluated 56 academic studies, companies with high ratings for ESG scores enjoy higher valuations, lower costs of capital, and outperform the market in the medium (three to five years) and long (five to ten years) term. **In this environment, best in class REITs recognize the importance of corporate responsibility, working to ensure positive relationships with customers, employees, regulators, and other stakeholders.**

ESG reporting is evolving at light speed. This white paper is admittedly not for everyone; leading REITs have been publishing corporate responsibility and sustainability reports for years, providing an ample roadmap for best practices. In addition, NAREIT has provided leadership and guidance that can be extremely helpful in building and refining a robust ESG disclosure practice. It is not necessary to go from one to 100 in one step, but at this point, **EVERY REIT** should have an ESG strategy. REIT executives and Boards of Directors need to develop and enhance their ESG policies and disclosures, or risk being left behind.

Environmental
Social
Governance

THE MAJOR ELEMENTS OF ESG

With the rapid growth of ESG reporting and communication, the specifics remain a bit undefined. The National Association of Real Estate Investment Trusts (NAREIT) has been a strong leader in providing guidance on ESG reporting, and examples of strong ESG disclosures. In addition, there are a plethora of organizations that offer various ESG scores and ratings, each with a different framework for analysis.

A good place to start is to understand materiality of each factor, which is different for most industries. There are several approaches to identifying issues that are material to an organization. For example, the Global Reporting Initiative (GRI) provides guidelines to identify material factors for companies and industries, using a top-down and bottoms-up approach. The Sustainability Accounting Standards Board (SASB) identifies material issues, which are the issues that are most likely to impact the financial condition or operating performance of a company within each major industry. For real estate, SASB identifies Energy Management, Water and Wastewater Management, Product Design & Lifecycle Management, and Physical Impacts of Climate Change, among 26 total factors identified.

Ultimately, companies decide what is financially material and what information should be disclosed, taking legal requirements into account. Many of the topics are common sense. Based on a review of best in class ESG reporting practices, below is a list of topics which are typically included.

Environmental

ENERGY EFFICIENCY & WATER CONSERVATION

1. Location / Proximity of properties and portfolios near to dense urban settings and mass transit access, for example:

- *Live / work / walk properties*
- *Access to / support of mass transportation usage, including company-sponsored discounts for mass transit usage*

2. Programs related to energy reduction, efficiency and conservation for all company properties, as well as corporate functions and operations, such as:

- *LEED / Green-certified buildings provide third-party verification*
- *Smart technology to reduce HVAC and lighting usage during peak and off-peak hours*
- *Sustainable and energy sources, such as solar panels to reduce demand for local utilities*
- *Higher efficiency lighting, HVAC, roofing / insulation to minimize energy usage and demand on local utilities*
- *Smart landscaping, storm water management, efficient irrigation systems to reduce demand for scarce water resources*

3. Companies will need to track data on energy and water usage, with specific measurement against goals to reduce consumption

RECYCLING / WASTE HANDLING

1. Redevelopment / refurbishment of existing buildings vs. ground-up development is generally seen as producing less waste in landfills, and lower transportation removal costs

2. Internal programs to maximize recycling, both within the corporate function, as well as across the portfolio, with significant encouragement for participation among tenants / customers

3. Vendor / tenant compliance; best-in-class REITs demand that major vendors / customers adhere to similar sustainability and efficiency goals

GREENHOUSE GAS EMISSIONS

1. Although difficult to track, public companies are being asked to disclose verifiable information detailing the carbon footprint of its portfolio and operations

2. Includes all greenhouse gas emissions for direct activities, purchased energy, and any extended impacts

3. Companies will need to provide descriptions of programs to reduce or mitigate emissions. Specific programs could include access to electric car charging stations, access to / corporate support for mass transit, etc.

CLIMATE CHANGE RISKS

Tools and methodologies to identify, assess, and address climate change risks, and how these factors are integrated into overall business strategy and risk management. Topics of focus include:

- *Diversification / concentration of assets*
- *Disaster preparedness / risk management practices / business continuity and crisis plans*
- *Financial risk assessments*

Social

GOOD CORPORATE CITIZENSHIP

1. How portfolios / properties play a role in providing housing, improving communities, supporting local employment, expanding business and personal income, and increasing tax revenue

2. Charitable activities, corporate and individual; company-sponsored matching gift programs

EMPLOYEES / PEOPLE

1. Code of Business Conduct and Ethics

2. Providing a safe and pleasant workplace

3. Health and safety

- *Robust benefits programs, including health and wellness programs*
- *Smart technology to reduce HVAC and lighting usage during peak and off-peak hours*

4. Expanded opportunities through training, support for education, mentorship programs, internal upward mobility, and internship opportunities. The success of a company's employee enhancement programs can be measured with statistics such as tenure, and retention.

2. Process for employee interaction and feedback, including townhalls, regular communication, and established review processes, among others

DIVERSITY, INCLUSION, EQUAL OPPORTUNITY, NON-DISCRIMINATION

1. Overall commitment to diversity, and specific strategies to accomplish diversity goals

2. Diversity goals apply to all levels of an organization, including senior management and the Board

3. Specific policies around workplace discrimination, gender, racial, and ethnic equality, diversity enhancement programs, and other workforce hiring and development practices. Also, it is important to ensure compliance with all applicable employment codes and guidelines, including:

- *Americans with Disabilities Act (ADA)*
- *Equal Opportunity Employer*
- *Non-Discrimination, Anti-Harassment and Non-Retaliation codes*
- *Established Whistleblower policy, providing a means for employees to report issues*

STAKEHOLDER ENGAGEMENT

1. Companies should have an established practice to communicate with, and collect feedback from, important stakeholder constituencies, including:

- *Customers / tenants / residents*
- *Employees*
- *Vendors*
- *Important community organizations*

2. Screening policies and procedures to ensure suppliers and vendors have strong social practices and acknowledge internal code of ethics

Governance

DISCLOSURES

Disclosures related to the system of rules, practices, and processes that direct and control the organization, including:

- *Robust benefits programs, including health and wellness programs*
- *Smart technology to reduce HVAC and lighting usage during peak and off-peak hours*
- *Corporate structure, guidelines and charters*
- *Alignment of interest between bylaws and shareholders*
- *Adherence to regulations. Policies and reporting mechanisms regarding anti-corruption and bribery, codes of conduct, conflicts of interest, whistleblower protections, anti-money laundering and anti-competitiveness practices. This applies to the company itself, as well as major customers and vendors*
- *Risk management; disclosures related to security, data, and financial risk, as well as overall company risk culture*
- *Description of the board's / relevant committee's participation in, and responsibility for, ESG program / performance. Also, a descript of an ESG committee, if appropriate, including participation of directors / executives / staff*

BOARD STRUCTURE

1. Size, diversity, and classification

2. Independence; percentage of directors and leadership

3. Separate Chairman and CEO roles

4. Provisions for employee communication and access

5. Accountability

COMPENSATION POLICY

1. Relevant compensation information, as well as descriptions of compensation policies

2. Alignment of senior leadership compensation with performance

3. Descriptions of key incentive programs, as well as any compensation tied specifically to ESG performance

SHAREHOLDER OUTREACH AND ENGAGEMENT

1. Comprehensive process: emails, calls, conferences, roadshows, investor days

2. Communication strategy needs to include passive investors / index funds

3. Percentage of equity shareholders engaged

Where to Begin?

IT STARTS AT THE TOP...

Top down leadership is critical to ensuring that ESG goals align with corporate core values of integrity, respect, and citizenship. In addition, commitment from the top ensures that the entire organization buys-in to its importance. Establish an ESG oversight committee, including Board / executive and employee participation. This committee will be accountable for the process, performance, results, and ongoing improvement. Prepare and commit to written policies, goals and objectives that can provide a clear path for each topic. Once goals and objectives are defined, it will be possible to identify results, define success, and drive continuous improvement.

...WITH A STATEMENT OF CORPORATE RESPONSIBILITY

A robust ESG program needs to align with a company's core values, and a Statement of Corporate Responsibility is a good start. This should emphasize that being a good corporate citizen and providing a good place to work are foundational principles. It should state that sustainability goals drive efficiency and reduce waste, improving bottom line results, long-term performance, and valuation. Also, it commits to strong corporate governance, aligning the organization's leadership with its important stakeholders.

COMMIT TO ROBUST ESG DISCLOSURE, AND MOVE FORWARD IN STEPS

In practice, a successful and meaningful ESG program needs to be more than just lip service. For real estate companies looking to take initial steps towards reporting on their ESG, there are several opportunities to provide information.

Summarize program detail in the investor deck.
Including one or two pages within a company's investor presentation is a fairly easy step to begin ESG disclosure. It elevates the information to a prominent and regularly-updated document, providing an easy reference point to which management can direct investors. This can be more high level information, detailing the importance of the ESG program for the company, highlighting its major attributes, and pointing to additional sources that provide more information

Disclosure in SEC filings.
A company's 10-K and Proxy should include a robust discussion of the company's ESG program, goals, execution and performance. As investors consider shareholder votes, access to this information in these SEC filings is critical. These disclosures are directly relate to risks faced by the company, and augment existing disclosures related to material risks.

ESG Page on the corporate and Investor Relations web pages.
A company's website should have a page that discusses ESG. Ideally, the ESG page would be accessible from both the company's main website, as well as its investor relations section, to highlight its importance. The webpage should highlight all aspects of the company's ESG programs, and provide a summary of performance and results.

Publication of a Corporate Responsibility Report
Best in class real estate companies produce an annual Corporate Responsibility Report, that details its efforts to be a good corporate citizen in all areas of environmental, social and governance factors. It should include an introduction from the CEO and / or Chairman, and review all of the key ESG factors, as well as a summary of goals, execution and performance. It should also provide all of the key data used to analyze sustainability and environmental impacts. It should be noted that publication of best-in-class corporate responsibility reports in the REIT sector are large undertakings, with significant time allocation and expense.

Proactively Control the Message.
As the interest in ESG information has grown, so has the number of organizations that review and report on ESG results, including: Bloomberg, Dow Jones, Global Real Estate Sustainability Benchmark (GRESB), ISS and Sustainalytics. Each of these organization gather different data points and metrics, and gather the information through different means. Some of these organizations aggregate information from publicly available sources, such as company filings, presentations, and reports. Others actively reach out to companies to collect information, through surveys and questionnaires. This highlights the need to proactively provide ESG information to the street, and have a fully-functioning ESG function in-house to ensure responsiveness to inbound data requests from investors and aggregators. While prioritizing inbound requests should grow easier over time as organizations consolidate and the most important resources survive, there is no choice: to not respond will create a black hole, potentially tarnishing management teams as ignorant, or out of step with best practices

SUMMARY & CONCLUSION

While ESG reporting continues to evolve, companies can no longer wait to adopt an ESG program, and communicating its goals, execution, and performance. Certainly, we expect that over time we will see better clarity and consistency of ESG goals and objectives. Also, certain aspects of ESG reporting, particularly around ephemeral topics such as estimates of carbon footprint, or exposure to climate change risk, are hard to estimate; establishing safe harbor provisions that cover ESG factor and limit the risk of retrospective litigation is critical. However, there is no debate that investor interest in this topic is expanding rapidly, and institutional capital will increasingly shift toward companies that meet the definitions of good corporate citizenship in all facets of its organization and operation.

Need help moving your ESG program forward? ICR can help. In addition to our real estate investor relations experts, ICR also has a team focused on assisting companies with ESG issues.

Contact Stephen Swett, 203-682-8377 or Stephen.swett@icrinc.com for more information.

ABOUT ICR

Established in 1998, ICR partners with companies to execute strategic communications and advisory programs that achieve business goals, build awareness and credibility, and enhance long-term enterprise value. The firm's highly-differentiated service model, which pairs capital markets veterans with senior communications professionals, brings deep sector knowledge and relationships to more than 650 clients in approximately 20 industries. ICR's healthcare practice operates under the Westwicke brand (www.westwicke.com). Today, ICR is one of the largest and most experienced independent communications and advisory firms in North America, maintaining offices in New York, Norwalk, Boston, Baltimore, San Francisco, San Diego and Beijing. ICR also advises on capital markets transactions through ICR Capital, LLC.

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