An environmental, social and governance programme for corporate real estate and facilities departments

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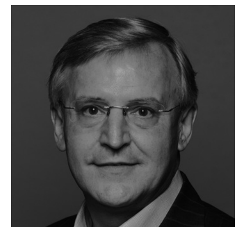

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ABSTRACT

A favourable environmental, social and governance (ESG) rating is of rising importance to companies because of expanding awareness and the growing acceptance among large investors that a robust ESG programme translates into strong market performance. Corporate real estate (CRE) intersects with many of the elements affecting a company's ESG objectives and plays a significant role in helping it design and achieve its ESG objectives. There is a lack of clarity among rating systems and users have difficulty correlating ratings to a CRE programme. While the make-up of a

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CRE programme for environmental is well developed, there are great opportunities for advancement in the areas of societal and governance. This paper addresses current ESG programme issues for CRE, offers suggestions for how CRE can approach them and provides a sample of how to develop an ESG programme for real estate that will help improve the company's performance and ultimately its market performance.

Keywords: environmental, social and governance, ESG, ESG programme, facilities management, corporate real estate, sustainability

INTRODUCTION

Society has long debated what to call influential aspects related to ethical and sustainable business practices. These names have varied from 'green' to 'social responsibility' to 'triple bottom line'. There seems, however, to be an acceptance and concentration recently around environmental, social and governance (ESG). In fact, companies still use the naming convention of corporate social responsibility (CSR) for self-reporting purposes and investors may use these reports as part of ESG scoring. Approximately 60 per cent of ESG raters in 2010 were dependent on CSR reports or similar public publications or requests for information and interviews from companies, and the firms that responded to these information requests did better than those that did not.[1] ESG connects corporate social performance (CSP) and corporate financial performance (CFP) based on a prior study in Hong Kong, which also found there was a positive market reaction to ESG initiatives on companies.[2]

THE GROWING IMPORTANCE OF ESG

ESG is growing in importance among investors and financial institutions when making an investment decision.[3] In addition, the debate about which criteria to use when evaluating an investment has a long history and inclusion of criteria beyond financial has been gaining momentum. For example, stakeholders have divested certain investments based on criteria other than pure profit. Consumers have boycotted companies and countries which have influenced social and financial change and there is certainly the impact on a company's reputation as well as its success with attracting and retaining talent. The debate from shareholder value to creating value for stakeholders has grown in public forums over the years; however, they are not mutually exclusive. For example, ESG helps create value through the focus on stakeholder interests and this focus can increase shareholder value.[4] Accordingly, demand rose in the 1990s for socially responsible funds and today this has increased to billions of dollars flowing into these investments; during the first half of 2019, these inflows exceeded 2018 by more than US$3bn.[5] While the growth of ESG and its importance on investments has certainly grown, the rating systems used for ESG are not consistent. Unfortunately, a globally consistent and clear rating system does not exist. It starts with self-reporting that does not use a common standard that providers use in their ranking process.[6]

While this makes it challenging to compare investments purely on ESG ratings, it is also difficult for practitioners or functional departments within an organisation to develop a programme.

> 'It has long been noted — usually with significant concern — that ESG/SRI rating and ranking organizations (and indices as well) frequently rate the same corporation's E, S and G elements differently.'[7]

CSR reports are also 'selective, subjective and not comparable'[8] and lack transparency and standardisation,[9] with ESG data coming from over 150 establishments that provide data to rating and ranking organisations. There are

dozens of rating organisations; however, the industry continues to consolidate, leaving MSCI and Sustainalytics as leaders.[10]

THE COMPLEXITY OF RANKING AN ESG PROGRAMME

This paper does not attempt to rank rating companies but, rather, highlight the various ranking processes and categories needed for a broad CRE programme to address the criteria of more than one. To do this, we start with the understanding of what ESG is and what CRE programmes and initiatives fall within the definition of ESG. While ESG can be considered as an alternative to sustainability, the definition is:

> 'a set of activity or processes associated with an organization's relationship with its ecological surroundings, its coexistence and interaction with human organisms and other populations, and its corporate system of internal controls and procedures (such as processes, customs, policies, laws, rules and regulations, etc.) to direct, administer and manage all the affairs of the organization, in order to serve the interests of stockholders and other stakeholders.'[11]

These sets of activities and processes have not been clearly defined for real estate in the detail needed to implement a CRE programme across transactions, facilities management and/or property management. While the rating system might be unclear and the correlation to a CRE programme hard to define, there is a path to an ESG programme for CRE leaders. ISO 14001 (Environmental Management System) standards could be used as an outline for ESG and CSR, although not the only model that would work for all companies.[12] In addition, there are no comprehensive tools or models that cover sustainability characteristics for all three ESG areas — that is, an approach that is practical for all companies.[13] The more a company discloses and increases transparency, however, the higher the score.[14] These scores can help investors identify well-run companies (eg data is showing that companies focused on sustainability practices outperform peers) and potential risks (eg Sustainalytics noted governance concerns with Volkswagen and Fiat before the diesel emissions scandal).[15] KPMG reported that of the world's largest companies by revenue, 93 per cent reported on ESG.[16]

THE ROOTS OF ESG

This is a good place to pause and provide a brief summary of the efforts of the early advocates for socially responsible investing (SRI) and how its advocates and thought leadership influenced policy, creating a foundation upon which ESG could grow and expand. The early adopters of SRI were convinced that investing needs to take into consideration factors beyond simply increasing profits for shareholders. The basic principle of SRI can be summed up with the simple tenet: 'Do no harm'. In the 1970s, the focus was on environmental protection.[17] In the 1980s, the boundaries expanded to address bad behaviour in the workplace, governance and social justice.[18] By the 2000s, large investors were focusing on sustainable investing, analysing a company's fiduciary duty, its impact on the climate and its corporate governance, believing that if the latter was done poorly it would be harmful to the markets.[19] These fostered the development of what came to be known as ESG.

The story for ESG begins in 2004 when the UN Secretary General invited CEOs of more than 48 major financial institutions to participate in a joint initiative under the auspices of the UN Global Compact.[20] The initiative intented was to find ways to integrate ESG into capital markets.[21] The term ESG was coined in a landmark study called 'Who Cares Wins' written by Ivo Knoepfel, issued in 2005.[22] The report argued that

embedding environmental, social and governance factors in capital markets make good business sense and lead to better outcomes. This includes how corporations respond to climate change, the quality of their water management programme, the effectiveness of their health and safety policies at preventing accidents, how their supply chains are managed and how the corporate culture builds trust among stakeholders. These are factors that were not part of a typical financial analysis but are relevant because of their impact on financial performance. At about the same time, the United Nations Environmental Program (UNEP) issued the Freshfield Report, which highlighted how ESG issues were relevant for financial valuation.[23]

These two reports were the foundation for the New York Stock Exchange's launch of the principles for responsible investment (PRI). The purpose of PRI is to encourage the integration of ESG into the 'analysis and decision-making through thought leadership and the creation of tools, guidance and engagement'.[24] Now it is almost universally accepted that implementing programmes that address corporate ESG risks can improve a company's financial performance. Consequently, ESG has been able to merge the purpose of socially responsible investing with mainstream investing.

Having ESG goals is great, but a corporation must be able to measure its progress in order to communicate to its stakeholders whether or not it is meeting its objectives for creating a better environment ecologically, corporately and fiscally. Towards that end the global reporting initiative (GRI), launched in 2000, provides reporting standards for corporations to follow. Presently, approximately 80 per cent of the largest corporations globally have adopted GRI standards.[25] The quality of ESG data is getting better and its accuracy is improving through the adoption of technology and the integration of data collection methods.

A key element affecting the accuracy of disclosure is the support of the corporate executives and their willingness to create a culture of compliance by holding a company's leadership accountable for aligning business operations with its ESG programme. The confluence of these historical factors and a corporation's commitment to meet certain ESG standards puts its brand on the line. This is where the CRE team plays an integral role. One way or another its actions and decisions affect nearly all the elements that influence ESG outcomes for the corporation. A CRE leader should be familiar with how to develop and lead an ESG programme, whether they are part of an internal task team across an enterprise, contributing to developing an enterprise programme, or creating one for the organisation.

UNDERSTANDING THE RATING PROCESS

When beginning to outline a framework for CRE, it is helpful to first understand the rating process. There are three steps to the process:

(1) Disclosure (eg GRI and the Sustainability Accounting Standards Board [SASB]);
(2) Rating (eg MSCI, Sustainalytics); and
(3) Rating reporting (selling of ESG scores).[26]

Disclosure is subsequent to action and determining the actions a CRE department can take to support the company's ESG disclosures starts with understanding each area of ESG. The environmental scope includes how companies address waste and carbon footprint, the social scope includes the engagement of stakeholders (eg workplace health and safety, protecting customer personal data, etc.) and the governance scope minimises fraud and threats to the roles of the board of directors.[27] Many CRE departments' sustainability programmes focus on

environmental areas such as emissions, utility consumption, recycling, etc.; however, little attention has been focused on social or governance areas.

There does not seem to be consensus on how to measure corporate sustainability; however, companies need indicators, measurement mechanisms and methodologies if they intend to report CSP as a source of value.[28] This problem becomes compounded given the data used in CSP may not be consistent with what the rating companies use. In addition, no two rating firms may use the same ranking criteria as it is up to them to set their categories of importance. When a company's ESG efforts are assessed differently, this can lead to many different and contradictory outcomes and results.[29] This difference in prioritising categories adds something of a challenge for CREs when ranking ESG initiatives and capital. There is some commonality in categories, such as the example shown in Figure 1, column 2. There one sees the usual classifications used among rating agencies as noted in earlier works done in the Harvard Law School Forum on Corporate Governance in 2017[30] and the Harvard Business Review,[31] along with some additional categories. Figure 1, column 3 provides examples of CRE and facility initiatives that correspond with a related category in column 2.

When reviewing each area of Figure 1, it should be noted that the CRE potential initiatives in column 3 closely align to historical sustainability programmes, specifically involving emissions, resource consumption and waste. In many cases, CRE departments have helped to lead this effort for their organisations. The largest future opportunity resonates with programmes and initiatives to support the social and governance areas. This will require the collaboration of other corporate departments such as human resources (HR) and procurement. For example, procurement may contract with suppliers who deliver facilities services and ensure the contracts include policies such as anti-bribery; however, a holistic programme would include ongoing performance management, additional compliance requirements, health and safety programmes and tracking of minority spend.

OPPORTUNITIES FOR IMPROVING MEASUREMENT, REPORTING AND COMPLIANCE

Certain categories in column 2 can be found in different ESG areas. For example, supply chain can be found in either social or governance categories. Supply chain can have an impact on many areas of ESG such as fair trade, diversity, minority spend, local protection, brand management, innovation, business continuity plans, bribery and corruption, fair wages, training programmes, etc. Given that most organisations use suppliers in support of delivering and maintaining their real estate portfolio, supplier management is a particularly important criterion. This includes the compliance and performance management of the supply chain from facilities services to transactions. In addition, given many of the facilities services are provided locally on-site, this presents an opportunity for small and large locally diverse businesses. Facilities and property management are heavily reliant on local services such as electrical, janitorial, grounds maintenance, plumbing, heating, ventilation and air conditioning (HVAC), etc. and this provides an opportunity for CRE departments to support their company's ESG programme and reporting.

Another area of opportunity is emissions. Buildings account for 40 per cent of emissions and reducing emissions includes the complexity of three stakeholders — the tenant, the owner and the property manager — and the fact that the real estate industry is slow to accept technology.[32,33] 'Data and technology will drive significant changes in our ability to measure, calculate

and monitor ESG factors and assess their materiality and impact on long-term value creation.'[34] Data and technology can help CRE departments with managing and measuring many of the initiatives for ESG, such as emissions reporting, consumption reporting (energy, water, waste, etc.), supply chain management and compliance, etc. While many CRE departments have focused on the 'E' of ESG and have programmes and initiatives around categories such as emissions, energy consumption, etc., they do not have a holistic technology or comprehensive data programme for all three areas.

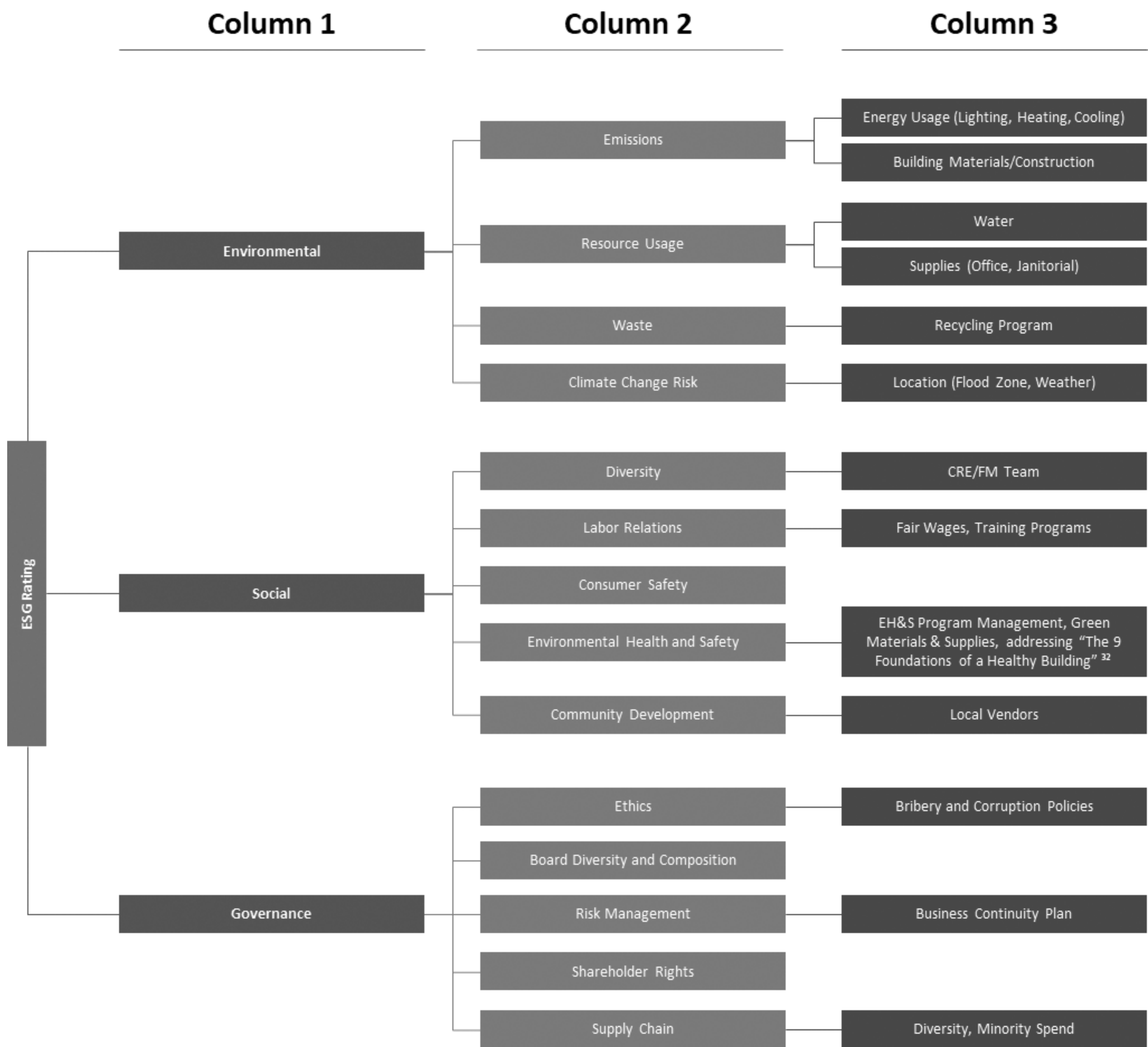

Figure 1: CRE ESG actions
Source: Authors/Harvard Law School Forum for Corporate Governance/Harvard Business Review

SEVEN STEPS FOR CREATING AN EFFECTIVE REAL ESTATE PROGRAMME

When considering developing a more detailed plan for developing an ESG programme, CRE leaders may consider using established programme management policies and tools, if they have already been developed and used across their company. In addition, it is helpful to have team members who understand local customs and governmental regulations on the implementation team. An alternative is to follow the seven steps outlined in Figure 2. These steps were identified to help CRE leaders develop and implement an effective real estate sustainability programme,[35] and can also be used to develop an ESG programme. Once a company has identified which real estate programmes it would like to develop based on the initiatives outlined in Figure 1, column 3, it can consider the steps outlined in Figure 2 to develop a plan.

CONCLUSION

The opportunity for a CRE department to help its company's performance and attractiveness to investors can be correlated to its ESG initiatives. Today companies are not legally required to provide a CSR report in countries such as the US; however, they may choose to use an existing framework (US GAAP, World Intellectual Capital Initiative, etc.), to develop one for their organisation or not at all.[37] Some of the existing reporting frameworks could become the mandated regulatory standards of tomorrow.[38]

Despite the industry challenges involving a lack of consistent standards for reporting and ratings, CRE departments can play an important role in supporting their company's CSR reporting and ESG programme. CRE departments should evaluate their existing sustainability programmes and reporting for the environmental area of ESG to ensure they have captured the categories used by rating agencies and are in alignment with their company's strategy and goals. In addition, they should evaluate or develop programmes for social and governance if they do not exist today. One of the areas that should not be overlooked is supplier management and compliance. This includes using technology to support these initiatives and programmes — for example, tracking areas of legal

Step 1: Commit	Identify goals in alignment with company vision, stated objectives and regulatory requirements. Similar to areas noted in Figure 1, column 3
Step 2: Organise for success	Ensure the right organisational structure, talent needed to implement the programmes
Step 3: Establish pillars	Programmatic view across certain areas such as energy, waste, etc. This includes an approach, identified initiatives and resources needed for each area of focus in a pillar
Step 4: Measure, measure, measure	Establish the baseline, track performance and analyse against the baseline
Step 5: Prioritise	Prioritise initiatives based on criterial (eg cost, payback, difficulty, etc.)
Step 6: Implement	Develop implementation programmes, identify leaders and conduct training programmes
Step 7: Report and communicate success	Communicate intent and success to stakeholders internally and externally, when appropriate

Figure 2: Seven steps to a sustainability plan
Source: Based on Temmink[36]

compliance, performance and support with minority and local firms and compliance with health and safety programmes.

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