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Measuring ESG in real asset funds – benchmarking, disclosure and driving better practice

Dominic von Wulffen Hello and welcome to this podcast. My name is Dominic von Wulffen and I am a partner in the Asset Management team at Allen & Overy in London. Responsible investing in sustainability is an increasingly important theme in the world of asset management. Today, I'm delighted to be joined by Steve Pringle, director of EMEA at GRESB and responsible for business development and client relations in that region. Steve comes from a banking and real estate fund management background and joined GRESB at the start of 2020. GRESB itself was established in 2009 by a group of pension funds who wanted to have access to comparable and reliable data on the ESG performance of their investments. It has since grown to become the global standard for ESG benchmarking and reporting for real estate and infrastructure investments across the world.

Steve and I will today talk about what GRESB does in the context of three main themes. First, what are the key elements of measuring ESG performance and how does GRESB approach this? Second, how does the GRESB approach to reporting and benchmarking in track with the EU's action plan for sustainable growth and the forthcoming EU regulations in that area? And third, how can the assessment and benchmarking of ESG performance create change in the wider world through the adoption by companies and asset managers of better ESG practices?

So turning to the first topic, Steve, welcome and thank you for joining me today. How would you sum up GRESB's mission and how does GRESB actually validate the quality and accuracy of the data that asset managers report?

Steve Pringle Thank you, Dominic for that introduction and thanks to Allen & Overy for inviting myself and GRESB to participate in today's podcast. So GRESB is a mission-driven organisation which is investor-led that's core purpose is to provide ESG performance data to our investor members. This data is provided by real estate and infrastructure, fund managers, asset managers, private equity houses and also investment trusts, and it's provided through self-assessments and self-reported data. This data is validated, scored and peer benchmarked. We're part of a unique global collaboration of investors, lenders, managers, service providers and industry bodies that has come together with a shared vision of sustainable real assets. Validation is conducted through automated and also manual validation. The automated occurs as a participant is completing the assessment via GRESB's online portal and the manual validation occurs by a third-party validator. GRESB works with this external validator to ensure that all the decisions accurately reflect the requirements set out in our different reference guides.

Dominic von Wulffen Tell me a bit more about that third-party validation process. How does a third-party validator actually go about validating data quality and accuracy?

Steve Pringle Our third-party validator GBCI, ensures that validation decisions accurately reflect the requirements set out in the reference guides. To ensure accuracy and the consistency across answers, the validators review all the answers of the specific indicators at a time, and they're typically assigned to validators that relate to these indicators. What this means is that an individual validator, so a human validator, they become experts on a series of these indicators so that there is a real set of consistency across these decisions that are being made. In 2020 we estimate that something like 38,000 human validating decisions were made across our assessments.

Dominic von Wulffen One of the arguments sometimes made against ESG initiatives is that they lack objectivity or quality control and that this can make it easier for companies and asset managers to greenwash that performance. How would you respond to that in the context of the GRESB assessment and benchmarking methodology? How do you get the balance right between, on the one hand, qualitative judgments and, on the other hand, quantitative data?

Steve Pringle Objectivity and quality control are two very important issues at GRESB and very important issues for our investor members and it's these investor members who provide the impetus and the direction for the real estate and infrastructure assessments. It's because of these members that GRESB's assessment has shifted towards more objective and quantitative data. As an example, this year in 2020 was the first year that the assessment was split into two components: a management component and a performance component. The management component covers mostly qualitative data, so your policies and procedures and reporting, for example, and that makes up 30% of the score. The performance component makes up 70% of the score and that consists mainly of the quantitative data of those underlying assets, so that's a very strong indication of how important that performance data is, given the higher regard for those points. The growing use of data technology by managers, by the participants, is increasing every year. The data partners who help the participants report, they collect the underlying asset level data live throughout the year and it's collected in a streamlined manner and then is added to the GRESB assessment or reported via an API connection. GRESB is strongly behind these data partnerships, as it makes validation much easier.

Dominic von Wulffen When you talk about the quantitative development component, would that capture measurable environmental impacts like water use, energy efficiency, waste disposal, that kind of tangible thing?

Steve Pringle Exactly, yes. These factors are all included in the assessments' performance component, as well as such things as greenhouse gas emissions. We're seeing quantitative tangible factors become much more of an issue for our investor members and in GRESB in general.

Dominic von Wulffen Thank you, and I think that brings us to our second topic. As many listeners will know, the European Commission released its action plan for financing sustainable growth in March 2020. In the coming two to three years, a number of regulations that affect almost every type of asset manager will take effect. In particular, the sustainability-related disclosures regulation will apply from next year and the EU's taxonomy regulation will apply from 2022.

Steve, how do you see these new regulatory requirements as affecting GRESB and to what extent does the data collated as part of the GRESB assessment overlap with the data that asset managers will need to report to regulators?

Steve Pringle

GRESB wholeheartedly welcomes the proposed regulation. We find it's a very large step in the right direction and identifies data collection as the key to achieving the EU's sustainability goals. GRESB has recently performed a gap analysis on the 32 disclosure factors that the EU has proposed. Between both our real estate and our infrastructure assessments we find a very strong alignment for the 2020 assessment, so this year's assessment, but we intend to even increase that alignment as close as we can to 100% for the 2021 assessment. We see it as GRESB's role to align ourselves to regulations such as this so that the GRESB participants can be assured that if they are participating with the GRESB assessment, then they know that what data they are providing is also being asked at the regulatory level.

Dominic von Wulffen

To put it very simplistically, the process of completing a GRESB assessment will actually cover the disclosures that an asset manager also needs to make under the disclosure regulation?

Steve Pringle

Yes, exactly. It's not so much the preparation, it's more the knowledge that if a participant's already reporting to GRESB, what they're disclosing will be required also by the EU. So this will help stop the growth of the ESG reporting burden for managers around the world and also asset managers and fund managers.

Dominic von Wulffen

Another EU-driven initiative that I think has had less coverage than recent regulatory developments is the carbon risk real estate monitor or CRREM. As I understand it CRREM evaluates carbon risk in the real estate sector and develops decarbonisation pathways for real estate assets, with the aim of keeping global warming below 2° Celsius. I understand that GRESB has been closely involved with CRREM and I'd be interested to hear a bit more about the initiative itself and the involvement of GRESB in it.

Steve Pringle

CRREM is something that GRESB is particularly proud about. We've been involved in CRREM since the programme began in 2018. We're one of the partners of the consortium, the other partners are four academic institutions and together CRREM was established to track the decarbonisation pathways for commercial real estate assets within the EU. 2020 is the first year the tool is available and next year it will also be available for countries and regions outside of the EU and it will also include residential real estate. Currently the CRREM tool fully aligns with the performance component information within the GRESB assessment - a real estate manager knows that they can easily go into the GRESB online portal once the assessment has been done, click a button and they will receive the CRREM Excel spreadsheet, which they can give to CRREM for free, and they will get their decarbonisation pathway.

Dominic von Wulffen

When we talk about decarbonisation pathways, are we just talking about targets that are aligned with the overall goal of limiting global warming or does the pathway also include the practical steps managers would need to take to reduce the carbon footprint of a particular asset?

Steve Pringle

First of all the pathways are aligned with the Paris climate goals of limiting global temperature rise to 2º with ambition towards 1.5º. These pathways enable industry stakeholders to estimate carbon stranding risk associated with premature obsolescence and write-downs. The CRREM tool identifies when an asset will become stranded, so when it hits that decarbonisation pathway between now and 2050, and it also provides an estimate cost, or a retrofit, to bring that asset back down well below that pathway. Again it's on track to meet that 2050 target.

Dominic von Wulffen

I think that takes us neatly to our third topic. How do you see ESG assessments and benchmarking as driving change in the asset management industry and in the wider world? And I mean both in terms of how managers evaluate new investment opportunities and also how they improve the sustainability of existing assets.

Steve Pringle

Peer benchmarking is fundamental to GRESB assessment, as it provides the managers and their investors with like-for-like comparable evidence between the funds and between the assets. This comparison helps spur improvement within the industry and also a desire to improve the fund or assets' ESG performance. Peer benchmarking appeals to our inherent competitive nature and it does so even more once the investor managers know that the institutional investors are looking over their shoulders to see how they're performing, both absolutely and relatively. Alongside benchmarking, GRESB sees the real-world change coming from regulation and it's how this regulation influences the industry which will really set the tone for increasing the ESG performance of the assets and the funds. It's this sort of regulation that GRESB needs to be aligned.

Dominic von Wulffen

That's very interesting. You effectively see your reporting and benchmarking as encouraging healthy peer competition and therefore better ESG performance in the real world?

Steve Pringle

Yeah, exactly. Peer benchmarking, it really comes into the funds managements industry, of that competitive nature; I come from the funds management industry myself and so I have seen it first-hand where looking at your competitors, what they're buying, what they're selling, how their funds are performing, that's part of GRESB too, creating that healthy competition towards a worthwhile goal.

Dominic von Wulffen Whilst sustainability, as I began by saying, is an increasingly popular topic, one of the challenges I think it often faces from critics is whether industry players and asset managers have the right incentives to actually take ESG seriously. That issue has come into the spotlight again with the Covid pandemic and some fear that ESG will take a back seat in the economic recovery from Covid. This is much too big a theme to frankly cover in today's podcast but I'd be interested to hear briefly whether you think that managers and investors will stay focused on ESG factors or revert to more traditional measures for financial performance?

Steve Pringle In regards to the Covid pandemic, I personally I don't see it will have a material effect on such things as the GRESB ESG assessment content, but what it may do is highlight how important ESG reporting is. It's already been well documented that ESG focus companies have outperformed their benchmarks and obviously the same happening to the same groups and how they handle such crises such as the pandemic when compared to their peers.

Dominic von Wulffen I hope you're right. Today GRESB focuses obviously on real estate and infrastructure but the themes we've touched on today affect almost every industry. So my final question to you ,Steve, is whether you see GRESB evolving as an organisation into asset classes other than real estate and infrastructure?

Steve Pringle GRESB's success has come from getting structured disclosure from privately held market segments, so that's really its differentiating factor. A natural extension would be into other privately held markets in real assets such as agriculture or forestry and especially the latter could become an important asset class to offset carbon emissions in our quest to avert climate catastrophe. Also a further extension could be into private equity but that would require a large investment from the GRESB organisation.

Dominic von Wulffen Thanks, Steve, and thank you again for joining me on the podcast. This has been, I think, a really interesting discussion that leaves much food for thought on how ESG factors will increasingly shape asset management in years to come.

Thank you to listeners for tuning in. If you do have any questions about any of the topics we've touched on today, do please feel free to reach out to me.

Steve Pringle Thanks Dominic.