Environmental, social and governance (ESG) integration – A property perspective

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Environmental, social and governance (ESG) investing encompasses many aspects related to allocating capital that were historically (deliberately or subconsciously) overlooked. In some cases, investors often (wrongly) viewed ESG investing as something falling within the purview of 'greenies' or some other 'extreme' ethical position.

We have seen in the past in financial markets, globally and locally, that, if left unchecked, ESG-related issues tend to lead to severe negative financial implications for shareholders, the environment and the well-functioning of society in the short and long term.

ESG integration is, admittedly, a somewhat complex process in practice that cannot be a 'tick-box' exercise. For ESG integration to be comprehensive, it should entail a thorough, dynamic assessment of the steps that companies are taking on matters such as energy conservation, carbon footprint, water usage, fair employment practices, inequality, corporate integrity and accountability, among others. Most of these factors, if looked at from an activist investment approach, often require time, deep and knowledgeable resources on the subject, as well as the existence of proper systems to track effective changes in behaviour.

Although we are proud of our achievements, the reality is that the industry at large (be it owners of capital, investment managers or corporates) still has some way to go in terms of having a comprehensive ESG integration process that informs day-to-day decision making. For investment managers, the challenge remains accessing relevant ESG data and translating that into information that can be used in valuing companies and ranking investment opportunities in a less subjective way. The good news, however, is that efforts from all stakeholders are all pointing in the right direction.

While we are doing our part in driving awareness on how we incorporate ESG in our investment processes, listed property companies (and many corporates at large) have increasingly become aware of the role they also need to play in society. For example, listed property companies have increasingly sought to reduce their carbon footprint by installing photovoltaic (PV) solar systems on roofs of their buildings and have started incorporating ESG reporting in their integrated reporting.

Redefine's 2020 ESG report notes that the company invested about R250m in solar PV installations and has increased its solar PV generation capacity to 25 913 kilowatts. This initiative contributed to reducing the company's carbon emissions by 33 607 tonnes of carbon dioxide equivalent during 2020. According to the company, this reduction in carbon emission is equivalent to eliminating the typical emissions of 7 260 passenger cars.

Given our constrained investable universe within the listed property space, eliminating companies that do not report widely on their ESG practices is often difficult. As such, we approach ESG integration with an active corporate engagement role in mind. Our focus is to encourage the company to adopt or improve aspects of ESG, and we assess each investment opportunity based on its best efforts.

How do we integrate ESG into our processes?

We have introduced an ESG rating methodology within our listed property team, working together with our wider Momentum Investments' team. The findings we obtain from our weekly ESG integration process are captured and used to guide our engagements with individual companies.

Issues we engage on range from unclear remuneration practices to issues such as lack of transparency in earnings reporting. We also exercise our rights by voting against company decisions that are not in the best interest of our clients. Our efforts are also placed on examining how companies reduce costs through green energy sources and their approach to electricity and water initiatives, as well as assessing continuity of skill and talent, and diversity at board level.

Examples of how we have engaged with companies on ESG matters in the property space

On director independence, our approach is that after non-executive directors have served on the audit committee of the board for more than nine years and more than twelve years on the board of directors, their independence credentials should come under more scrutiny, as the familiarity between the directors and company management would have grown substantially.

A company might declare a board member still independent after an extended length of service, but a continual refreshment of boards is the best way, in our view, to ensure there will always be board members who can question the way the company is run with new and independent eyes. This will ensure there is a better level of peace of mind for shareholders that the board has not become a club of like-minded individuals.

There was an instance where two independent non-executive directors had more than 15 years as board members. We shared our view with the company and the company CEO expressed an opinion. The CEO of the company maintained that he needed the individuals as independent non-executive board members. It has always been our view that if a company requires the service of a non-executive director for scarce or unique knowledge, insights and experience, then these non-executive directors should be appointed as non-independent non-executive directors to garner positive votes for re-election. In the end, the company still listed the two directors as independent, now going on 17 years of service. We continue to vote against their appointment as independent non-executive directors.

Using the same company, we can highlight why one negative governance-related issue can be offset by taking positive steps to protect the environment and contribute to addressing inequality. We engaged with the same company on their environmental and social initiatives. Our discussions were focused on the company's environmental sustainability plans that have been in place since 2015, which centred on the company's electricity and water initiatives. The plan focused on reducing its tenants' environmental footprint by using green energy sources, reducing consumption and optimising utility usage.

To bolster this skill set, the company appointed an engineer to drive the initiatives and provide sound metrics of its progress on these matters. This is positive, as it brings experience into the process. Our discussions with the company also centred on the work done by their academy, which seeks to empower young, black professionals with skills to develop their careers in property development and investment in South Africa.

At Momentum Investments, we believe a focus on ESG contributes to society, the environment and shareholder returns. ESG integration is an essential part of our responsibility, and we will continue to exercise our responsibility as investors and look to build on our current efforts. Therefore, we are proud of the efforts we have made on integrating responsible investment practices in our portfolios and the role we play in being good custodians of the investments we manage.