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2022 – Mind the ''data'' gap

One year ago, we wrote a whitepaper called "Turning up the volume, cutting through the noise". This paper was about the journey ESG data vendors find themselves on today. We especially stressed the importance of the availability of comprehensive data to properly address issues. For a sector that is responsible for over 30% of the global Greenhouse Gas "GHG" emissions, one cannot underemphasize the materiality of this sector to save our planet. Things have certainly evolved since then and thus we believe it is a good time now to revisit the progress on this front as the regulators, asset allocators, corporates and investment practitioners are justifiably faced with increasing demands for progress reporting and benchmarking when it comes to decarbonization of their investments. As the thresholds and benchmarks for sustainable activities and investments become even broader, we need to showcase how certain data dilemmas in the ESG world can unfortunately end up distorting both the regulators' decarbonization aims, and concurrently can cause for misallocation of capital, barring a more sophisticated approach. More importantly, we need to showcase what can be done in terms of solutions to speed up the true decarbonization progress.

It is our deep responsibility as active managers and prudent stewards of our clients' capital to only allow high quality data to enter our investment process. This is of paramount importance in making accurate assessments of the future value of real estate companies, in our view. It also allows us to actively engage with companies in an effective and focused way and thus work towards the ultimate goal of Paris-target aligned decarbonization.

All material scopes of emissions need attention
More often than not a short-cut is taken, due to the lack of reported data, to create decarbonization targets and benchmarks based on Scopes 1 and 2 emissions and then compare companies or funds based on that. We believe strongly that we are not yet in a phase where reporting coverage is sufficient enough to make benchmarking targets based on these. In the case of Scope 1, these are often energy emissions that are directly generated by the real estate landlord (often not material unless the landlord has its own energy production operations or a material vehicle fleet). Scope 2 emissions relate to the generation of the emissions that are purchased by third parties to run the business, otherwise known as indirect. Scope 3 emissions are those that the company does not directly control. When looking at the standards for reporting GHG emissions by real estate companies there appear to be immediate differences in how emissions shift in between the various scopes.

Direct emissions of Scope 1 and 2 might make up most emissions for an office landlord due to the direct control over the operations of the building, but these will make up an immaterial portion of the total emissions for those landlords which have predominantly Triple-Net leases (such as many industrial landlords). As an aside, triple net leases pass on nearly all the responsibility of the costs in running the building to the tenant (e.g. insurance, energy and maintenance). In plain words, this means that the tenant is in control of the day-to-day operations of the building and pays for all those expenses. It also means that the landlord's Scope 1 and 2 emissions are only those associated with their head (or regional) offices. Based on our own research, only 15% of the global developed listed real estate companies sufficiently measure fully verified GHG emissions across all material scopes and only 10% of the companies have Net zero targets on all three scope emissions by 2050.

Bigger does not automatically mean better
One can imagine how this introduces all kinds of measurement errors. For example, a large company will report erroneously lower Scope 1 and 2 emissions per million of revenue (or total square meters) as the numerator will be the emissions from the head office, and the denominator will be all the buildings they own, which fall in Scope 3. Reporting all three scopes is difficult as tenants have to cooperate, but it is the only way to get meaningful and comparable data on the full picture of these. In the meanwhile, companies need to be spending time engaging with and showcasing to their tenants why it helps everyone if they report the emissions, and come up with cost saving and GHG reducing capex plans.

Furthermore, standardization of reporting is already addressed by the Task Force on Climate-Related Financial Disclosures "TCFD" whereby the aligning of measurements and reporting to these standards can go a long way. Unfortunately, based on our primary sourced data, thus far only 4% of the global developed listed real estate companies report fully in line with TCFD, but a materially higher amount have committed to do so – a welcomed initiative.

Modelled emissions can be far from actual emissions
We commend the ESG data vendors' relentless efforts in running sophisticated models to estimate emissions where companies do not report actual emissions data. This is a gigantic task which will take years to perfect. However, where we stand today, as companies begin to get a stronger grip on their emissions and can report their preliminary numbers, we see in the real estate space huge discrepancy between what the modelled emissions were by the reputable data vendors, and what the actual emissions were. More often than not, the errors can be a multiple higher or lower than the meaningful reality.

We do not at all mean to imply that the data vendors are not doing enough; they can only do so much when the primary sourced data from the underlying companies is lacking. Given that this real estate emissions reporting set is in its infancy, it's actually completely normal to have numerous errors of this type. However, it also means that, with limited actual reporting coverage, the GHG intensity numbers would be often meaningless. This problem is amplified when emissions get switched from 'modelled' to 'actual' as and when reporting quality improves and companies get a grip on their emissions in a confident enough way to publish them. This has the result that any time series for comparability across years of decarbonization progress can be nearly meaningless. Asset allocators and investors need to be weary in passively allocating capital to non-active strategies which benchmark themselves on low-quality data, as the impact of these investment may not have the desired result.

So what do we do about it? Ignoring it or complaining will not suffice
We have spent some time tying the theory of the ESG data issues with the practice of what can go wrong as data sets keep on maturing. However, useful calling out of the issues, digging through them and understanding them fully, hardly offers a solution - which is what it's all about. As active and responsible stewards of capital we have been entrusted by our clients to dig deep and make actual change. Therefore, rather than allocating capital based on quality of data we believe to be at this point not mature enough for proper usage, we integrate ESG into the valuation of the companies we invest in and reward them based on every incremental progress along the way. These include but are not limited to: introducing Science Based Targets, Scope 3 calculation which is verified, detailed capex plans aligned to decarbonizing the real estate stock, ESG targets as part of long-term incentive plans and many more. This way we can engage with the companies to begin or accelerate their decarbonization journeys and remain willing, able and committed to change. We also work with the companies to help them effectively measure their emission scopes via sharing

best practices across regions and across sub-sectors. This way we can attempt to solve the data quality issue right at the root of the problem. These initiatives should result in better data, investment decisions and capital allocation not only for the benefit of Kempen's clients, but for the industry as a whole.

It is also important to point out that we leave no one behind, we engage with the lagging companies as often these are the companies that need the most pushing and sharing of best practices, and this is often where the biggest marginal improvement can be done. And to us this is what it's all about: actual change and moving the needle rather than quick decisions and masked progress based on suboptimal data. We have built an Environmental Pathway Framework that requires us to analyse over 300 REITs and private real estate funds. Encouragingly, 74% of the global listed real estate companies have a stated decarbonization strategy, based on our primary research sources.
Finally, we work closely with the data vendors to help improve the quality of the data when we catch the errors. The data vendors are not real estate specialists, but we are, and thus a joint effort can only strengthen the output for the whole industry. Together, regulators, asset allocators, active investment managers and the real estate asset owners can tackle this challenge head-on with persistency and make true progress towards the ultimate goal.

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