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Responsible Investment in Listed Real Estate (LRE)

July 2022 (v2022.11)

1. Introduction

As a long-term investor, PGGM Vermogensbeheer B.V. (PGGM Investments, hereinafter PGGM) is committed to investing responsibly. PGGM manages its clients' Listed Real Estate (LRE) investments in order to contribute towards a stable pension for their participants while also taking into consideration its impact on the world. PGGM recognizes that environmental, social, and governance (ESG) factors have a material impact on the financial performance of the portfolio, especially in the longer term. As such, integrating ESG issues into investment analysis and decision-making processes is part of its fiduciary duty.

This guideline addresses PGGM's management of ESG issues with regard to LRE. The guideline is a further refinement of PGGM's Responsible Investment Framework and its implementation guidelines and the relevant fund prospectus and ancillary documentation. In addition, the obligations arising from compliance with legislation and regulations apply. The guidelines cover all investments made by LRE, effective as of 1 January 2021.

2. Investment strategy & approach

PGGM's LRE fund objective is to invest in real estate securities and deliver above benchmark returns on a risk-adjusted basis over the long term (full real estate cycle of between 10 to 15 years). In this bottom-up stock selection oriented investment process, material ESG factors are taken into consideration in the fundamental investment analysis to ensure that the rapidly evolving physical and regulatory ecosystems, in which these real estate companies operate, are accurately translated in our assessments.

By having in place a transparent responsible investment guideline for LRE, as further outlined in this document, and by actively taking into account ESG-related performance in investment decisions, the team believes that it offers a positive contribution that is best practice and in line with the clients' stated objectives.

The relevant standards, codes of conduct or (inter) national initiatives or legislation that apply and have an impact on implementation are discussed below. For more detailed information please see PGGM Investments website.

3. Implementation

3.a ESG-integration

PGGM defines ESG integration as systematically taking into account those ESG factors that have a material effect on investment risk and return. Across its entire portfolio PGGM uses the Materiality Map of the Sustainable Accounting Standards Board (SASB) as the framework to identify material environmental and social issues. Similarly, LRE takes SASB Materiality Map into account when analysing environmental and social risks and opportunities in the investment process.

LRE also considers corporate governance factors to have a meaningful impact on the long-term success of companies. For corporate governance related issues, the team refers to the International Corporate Governance Network (ICGN)'s Global Governance Principles as well as our in-house framework.

ESG is incorporated in the investment process: (1) in the screening of the investable universe to select the research universe, which is the subset of companies actively being researched by the LRE team, and (2) as an integrated element in the team's fundamental analysis to value a listed real estate company in order to assess the future expected return. Below more insights will be given.

LRE combines indicators from the SASB Materiality Map (discussed above), corporate governance datasets, GRESB (a real asset ESG benchmark), and Bloomberg ESG, to arrive at company level ESG peer analyses. This gives our portfolio managers insights into how well each company has performed on financially material ESG factors, indicates the robustness of management quality, and offers insight into how well companies have performed against competitors on managing known ESG risks. In the team's fundamental investment analysis ESG integration is aimed at identifying and translating relevant ESG factors in upside potential and/or downside risk.
In principle, ESG integration is applied for 100% of the research coverage and, thus, has a wider reach than just the LRE portfolio (integrated across the universe).
In addition to environmental and social factors covered by SASB, LRE also integrates corporate governance issues into company assessment. These include topics such as:

- Executive and director compensation
- Board compositions and oversight abilities (independence, diversity, committee structures)
- Shareholder rights and minority shareholder protections

LRE recognizes that the natural, regulatory, and tenant demand systems in which listed real estate companies operate are changing at unprecedented rates. These changes create material opportunities and risks for the LRE portfolio. We focus on the ESG risks that we think are (1) the most likely to materialize, and (2) would have the greatest impact on financial performance between companies in the research coverage.

These are:

- **Governance risks:** Poor board oversight, low pay-for-performance based executive compensation, and lacking minority shareholder protections.
- **Low-Carbon Transition risks:** Energy and emissions profiles of buildings, carbon taxes, and reporting requirements.
- **Physical climate risks:** Extreme weather events, sea level rise, and temperature rise.
- **Social and reputational risks:** Diversity, health and safety, and satisfaction of workforce.

To what extent these factors affect the value of the investment, depends on what factor is being considered for a specific listed real estate company. The impact of these ESG factors will vary on a company by company basis. With ESG being part of due diligence the analysts are carrying out, the LRE team believes it is appropriate to integrate ESG factors into the valuation framework, and have these translated into the assumptions made for operating cash flows, asset valuations, capital expenditures, and premium/discounts setting (if and when deemed material).

The LRE team is currently in the process of developing an ESG factor attribution to monitor the effects of specific governance indicators and combinations of indicators, on financial performance of companies in the U.S. universe. This is the first step in a wider initiative, with the ambition to rollout the methodology and learnings across other ESG indicators and regions over time. Ultimately, this effort should help us better understand what ESG factors will materially drive future outperformance and are supportive to the fund's overall medium/long-term objective.

To support our ESG analysis and engagement, we use data provided by Bloomberg and GRESB, as well as in-house analyst research. Additional third-party data for specific ESG topics, such as physical climate risk data, is expected to be on-boarded to the LRE platform over the course of 2021. Peer companies are benchmarked on individual ESG indicators, or combinations of indicators, and ranking results are visualized in proprietary dashboards.

These quantitative elements are combined with qualitative assessments of companies' strategic direction. This level of assessment is often best gauged through one-on-one dialogues or other feedback sessions with companies' management. The goal is to understand companies' plans of action on ESG and to influence companies for a resilient path forward. Most of the ESG datasets we use are updated annually. Governance datasets tend to be updated more frequently to account for changes to board structures and other important factors that are disclosed more frequently than annual reporting cycles.

ESG information is integrated directly into our fundamental valuation framework for listed real estate companies, meaning that it is inextricably linked to our view of a company's valuation in the medium term. A company valuation underpins the medium term return expectation, while the return expectation is the most important determinant in the portfolio construction process. The LRE team believes ESG has to be an integral part of its fundamental analysis process, and has ESG factors directly translated into a company valuation and return forecast.

In the process of selecting the research universe, which is a subset of the index universe for which the analysts are required to maintain up-to-date fundamental research and a valuation framework, the LRE team will filter the entire investment universe based on various criteria (including company free float, stock liquidity). In this selection procedure, the analysts will also have the opportunity to articulate why a particular company should be excluded on the basis of poor ESG practices. Such exclusion will lead to a "red flag" if an analyst cannot find comfort in the ESG practices when underwriting the valuation of the respective company. In such case, the analysts will not be required to actively follow the company and the fund will not invest in such company. When the opinion/perception on a red flag changes and the analyst is comfortable in underwriting, the analysts will also have to substantiate the rationale for changing opinion before the company will be taken into consideration in the research universe and before any investments can be made.

As described above, ESG is integral part of the fundamental analysis process, and hence all analysts will conduct bottom-up research on various matters including ESG relevant to the respective listed real estate company. To support a substantiated opinion, analysts will make use of company filings, publicly available information, products of third party research vendors as well as proprietary data sets. Additionally, through engagement with companies the LRE team may be able to get a better understanding of the direction/strategy taken by the company's management as it relates to future ESG efforts. As part of having the fundamental research up-to-date on an ongoing basis, the analysts will continuously have to monitor ESG conduct for all companies in the research universe. Given the dynamic nature of the portfolio construction and the return optimization of the portfolio, and, subsequently, the rotation of positions in companies, any company in the research universe could become part of the LRE portfolio at some point, which warrants a continuous effort in screening for ESG risks (pre- and post-transactions).

3.b Impact

In addition to a better-performing portfolio, PGGM seeks to enhance the positive impact of its investments and to minimize adverse impacts.

1. Positive impact: investing in the SDGs

In 2016 PGGM and APG defined Sustainable Development Investments (SDIs) as "investments that yield market-rate financial returns while generating a positive social and/or environmental impact" (i.e. contribute to the Sustainable Development Goals). In 2020 Australian Super, British Colombia Investment Management Corporation joined APG and PGGM in the SDI-Asset Owner Platform which owns a taxonomy of products and services (solutions) that contribute to the SDGs. With a set of decision rules the taxonomy forms the basis for the classification of investments as 'SDI'.

PGGM main client's ambition is to increase the SDI volume to 20% of the total portfolio by 2025. The effort to measure portfolio companies' real-world impact, however, is currently limited to seven focus SDGs: #2 (zero hunger), #3 (good health and wellbeing), #6 (clean water and sanitation), #7 (affordable and clean energy), #11 (sustainable cities and communities), #12 (responsible consumption and production) and #13 (climate action). To estimate and monitor the impact on these focus SDGs, the indicators suggested by the Working Group on SDG impact measurement of the DNB-facilitated Sustainable Finance Platform are used.

2. Minimise negative impact

The social and environmental impact of the capital entrusted to PGGM by its clients is significant. PGGM can stimulate a positive contribution to a sustainable world and has the responsibility to minimise adverse impact (when efforts are not in conflict with the company's financial performance and valuation, as well as the broader LRE objectives). Adverse impacts refers to negative impacts (harm) to individuals, workers, communities and the environment.

As from 1 January 2022 at the latest, PGGM shall avoid new investments in companies that are in very severe violation of the OECD Guidelines for Multinational Enterprises (hereinafter OECD guidelines) and/or the UN Global Compact principles. When feasible, PGGM shall undertake best efforts to divest existing exposures to these companies all together and/or shall engage with the companies, or a selection thereof, that are in (very) severe violation of the OECD guidelines and/or the UN Global Compact principles.

Based on its high likelihood and severity, climate change as a driver of adverse impact is prioritized. Clients of PGGM's have committed themselves to the Dutch Climate agreement[1] and to the Paris Climate Agreement to align policies consistent with the objective to limit the global temperature rise to a maximum of 1.5 °C. The ambition is to have a climate neutral investment portfolio by 2050 - in line with the ambition of the European Union and the Paris objectives. LRE annually reports its carbon footprint.

3.c Stewardship (engagement, voting, shareholder litigation)

PGGM sees it as its responsibility to engage with market parties and companies about their policies and activities. In this way, it attempts to realise ESG-related improvements. If PGGM is also a shareholder in a specific company it applies customized voting principles, written down in the PGGM Voting Guidelines.

PGGM LRE actively use its influence as a shareholder to improve ESG performance of companies, thereby contributing to the quality, sustainability and continuity of companies and markets. This is done through three key areas: Engagement, Voting, and Litigation.

Firstly, for all companies in the LRE research universe, the LRE team conducts a company-specific ESG screening, with the ambition to formulate the top 5 priorities for each company under coverage. This prioritization is done on the basis of estimated impact on the company's financial performance and valuation. The assessment and priorities will be detailed in a company-specific roadmap in order to help steer our engagements efforts to the most relevant and material ESG subjects. By means of a company-specific approach, we acknowledge that the impact of ESG subjects may differ company by company.
Aiming for a constructive dialogue at first, the LRE team conducts company engagement through management meetings with the executive and supervisory boards to formally encourage improvements on material ESG factors. LRE engagement activities focus on improving companies' ESG transparency and on further integrating

1 In Dutch "Klimaatakkoord"

best practices into the long-term business strategy. Engagements are also initiated, for example, as a result of changes in ESG performance/profile, the agenda of shareholder meetings, and/or media attention. Any progress made on milestones in the roadmaps will be documented in these company-specific roadmaps.

All LRE engagements are logged in a shared Excel file and company specific engagement file to monitor progress. Within the team, engagement successes and best practices are discussed. Information and insights gained from company analysis and engagement may lead to a re-assessment of the holding in a company. LRE engages with companies on all the three themes: environmental, social and governance However, there are varying degrees of priority based on materiality in terms of risk and return to investee company and the fund. In addition to this, the LRE team engages with stock exchanges and regulatory bodies in order to discuss current policies and anticipated policy changes relating to topics such as minority shareholder protections, board independence, and other ESG related issues.

The LRE team has developed "engagement roadmaps" that lay out the top value added engagement priorities, as determined by the team for each company, clearly outlining the potential financial impact on the company's financials and valuation. These roadmaps include descriptions of the material changes we would like to see, a substantiation of financial impact, the rationale for why we would like to see them, and milestones to measure company progress against these changes. Roadmaps are shared with companies so that they are fully aware of the team's expectations and perspectives. This level of engagement clarity has shown to lead to highly constructive conversations with management, and, thereby, to progress on material ESG factors.

PGGM applies customized voting principles across all its listed equities, including listed real estate, as detailed in our PGGM Voting Guidelines. Our active and informed voting strategy allows us to address a wide variety of ESG matters. In addition, in many countries, we have the right to submit shareholder resolutions as a last resort for ESG improvement. These enable us to draw attention to material issues and request other investors to express an opinion by voting at a shareholder meeting.

Engagement and voting presents an opportunity for our portfolio managers to gauge the sophistication and vision of company leadership. This helps them to make informed adjustments to valuation assumptions, including the premium/discount rates.

Litigation

When necessary, we institute legal proceedings against companies to recover any investment losses and enforce good corporate conduct. PGGM has the following principles for the conduct of litigation:

- **Financial proceeds to limit damages:** Recovering for and on behalf of PGGM's clients' investment losses resulting from fraud, corruption, embezzlement or other forms of misconduct by listed companies.
- **Contribution to the risk-return profile:** Where possible, improving the corporate governance of the company concerned in order to remain invested as a shareholder with a long-term outlook.
- **Prevention:** Setting standards to prevent undesirable behaviour (fraud, corruption, deception etc.).

3.d Exclusion

The PGGM Implementation Guidelines on Exclusion are applicable to investments in all asset classes, including LRE. The PGGM-wide product-based Exclusion List consists of companies engaged in controversial weapons, tobacco, tar sands as well as thermal coal utilities and mining companies.

By excluding companies on the basis of the above elements, PGGM seeks to prevent PGGM-managed investments contributing financially to practices incompatible with the standards and values of PGGM, its clients and their beneficiaries.

4. Transparency

Each quarter LRE provides an update of its responsible investment activities in the clients' quarterly report. This includes information regarding stewardship activities and integration of ESG-factors in its investment decisions. Also, any relevant negative impacts and our monitoring of these impacts, are to be reported in line with the SFDR Regulatory Technical Standards (RTS) once they are finalized. In addition the team contributes to PGGM Investments annual Integrated report and report on its responsible investment activities in the Principles of Responsible Investment (PRI) annual survey.

5. Annex

Please note that there is an Annex applicable for this ESG-guideline. This Annex forms an integral part of this ESG-guideline and may be updated from time to time. The applicable Annex is available on our website.

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22-12692 juli 2022