RESOLUTION CAPITAL

# QUARTERLY ESG AND STEWARDSHIP REPORT

REAL ASSETS STRATEGY

JUNE 2024

# ESG Commentary

## Cromwell Property Group announces innovative sustainable loan facility

Sustainable finance frameworks are gaining popularity among A-REITs. A sustainable finance framework provides a structured approach that incorporates environmental, social and governance considerations into financial decision-making and describe the methodology used to classify financing as sustainable for the purpose of tracking and disclosing performance against sustainable finance targets. Several A-REITs have adopted these frameworks and have issued green bonds or sustainability linked loans, such as Dexus, Mirvac, Arena REIT, and Cromwell Property Group. These products aim to raise capital in order for the company to achieve sustainability goals such as enhancing energy efficiency in buildings, increasing renewable energy generation, or meeting gender diversity targets. While pricing incentives have historically driven participation, this is no longer universally the case.

Increasingly the benefits of this type of financing is that it enables access to a wider range of capital, particularly as banks and investors often also have targets for verifiable sustainable or green investments. Green and Sustainability Linked Loans have requirements around what the funds can be used for, as well as regular reporting and disclosure requirements, meaning there is more certainty that these types of labelled debt instruments can fulfil requirements for investing in "sustainable" activities. These can include linking financing to the achievement of carbon reduction or net zero targets, the roll out of renewable energy projects or energy efficiency retrofitting to achieve a minimum green building certification, like NABERS Energy or Green Star.

Cromwell Property Group is a good example of how a Sustainable Finance Framework can be used to support funding for low-carbon real estate projects, as well as social initiatives. In place since 2022, the framework has been used to secure more than €600 million in green financing to upgrade the energy efficiency performance of buildings across its international portfolio.

In June 2024, Cromwell announced an innovative debt restructure to transfer an existing loan facility of approximately A$1.2bn, to a sustainability linked loan with sustainability requirements related to its decarbonisation efforts and its gender pay gap. What makes this particularly interesting is the focus on both environmental and social goals, such as increasing interim carbon reduction targets for Scopes 1, 2 and Scope 3 emissions reduction and targeting a reduction in the company's gender pay gap. The Scope 3 emissions reduction and the gender pay gap have deadlines by 2028.

While the pricing benefits of this facility haven't been disclosed, for Sustainability Linked Loans such as this one, there is typically a penalty in the form of increased interest rates if sustainability targets are not met and beneficial pricing if they are met. However, the pricing benefits of sustainability and green loans appear to be narrowing and the broader benefits of having access to a wider pool of investors is becoming more important. This wider pool now includes investors that themselves have sustainable investment mandates and need to be able to link investments to sustainable activities (ie green building retro fits and reducing gender pay disparity) that are verified.

# Portfolio Metrics

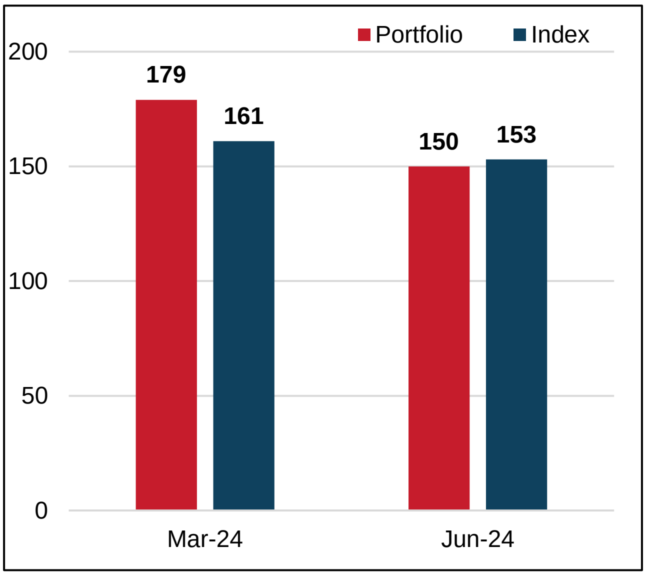
## Carbon Emissions

The carbon emissions and carbon intensity of the Portfolio versus the index are monitored and measured on a quarterly basis from data sourced from the GRESB[1] company assessments, MSCI, Bloomberg and company disclosures. The charts below illustrate the carbon intensity of the Portfolio versus the benchmark[2] as of 30 June 2024.

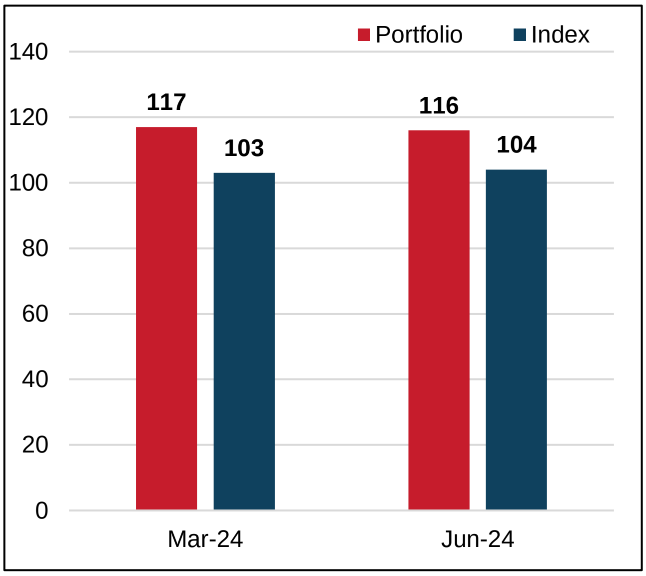
This quarter the Portfolio's revenue-based carbon intensity reduced to be in line with that of the benchmark's, however, the area-based intensity remained above that of the benchmark. The area-based carbon intensity for the portfolio remains higher than the index due to the larger portfolio positions (by weight) in the retail REIT Scentre Group (SCG) and data centres and towers REIT, Digital Realty (DLR).

Retail REITs are typically more carbon intensive than other property types due to several factors, including high interior and exterior lighting density, increased demands on central air conditioning from more open spaces, increased interior lighting levels, and from cooking and refrigeration activities.

**Carbon intensity (Ton/US$1m Rev)**




**Carbon intensity (kg/m²)**




Source: ResCap, GRESB, Bloomberg, company disclosure, 30 June 2024
Index: S&P ASX300 / A-REIT constituents

The chart below shows the revenue-based carbon intensity on a sector-by-sector basis in the Portfolio and the index. The largest Portfolio overweight sectors are the non-REIT sectors utilities and infrastructure, followed by the childcare and residential REIT sectors.

Stock selection within the overweight positions in the childcare (3.5%) and residential (2.7%) sectors, as well as in the large underweight position in the diversified sector (-12%), contribute to offsetting the rise in carbon intensities caused by the significant carbon intensities in the utilities sector (4.9%), which is dominated by the U.S. based electric utility, Dominion Energy (D). Over the last quarter, our utilities sector holdings have shifted slightly, contributing to the reduction in overall revenue-based carbon intensity. This change was a result of exiting the position in Italian electricity transmission operator Terna (TRN-IT) and adding UK operator National Grid (NG), which is a less carbon intensive utility.

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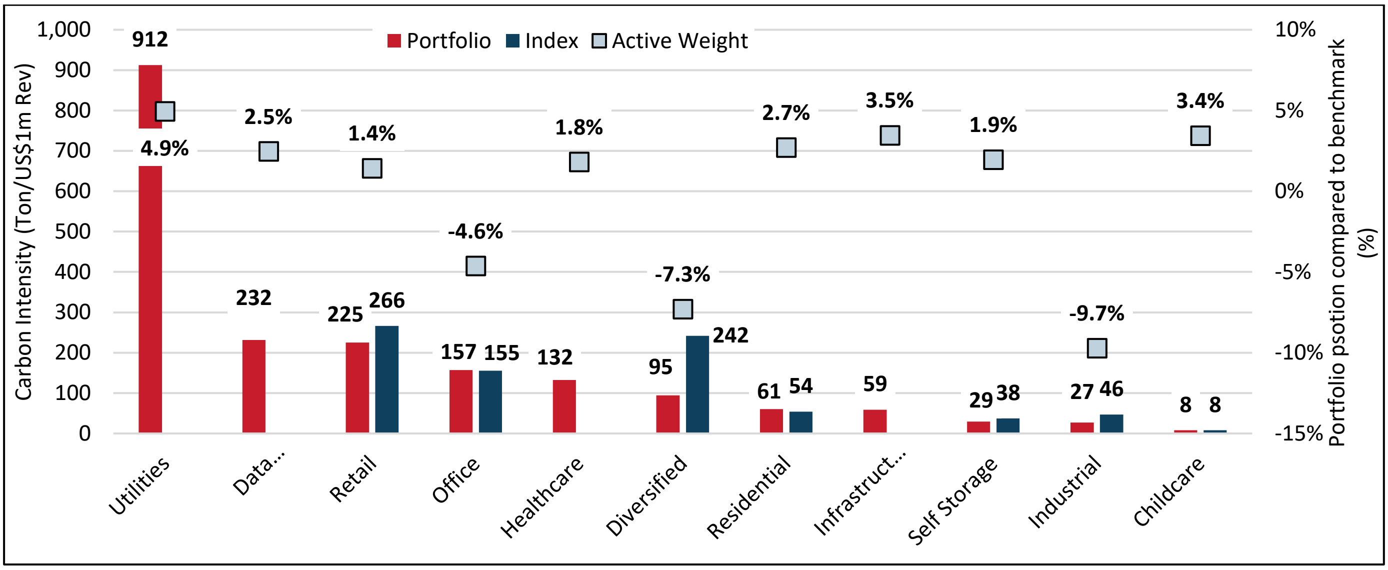
[1] GRESB is the Global Real Estate Sustainability Benchmark, an independent organization providing validated ESG performance data and peer benchmarks for investors and managers to improve business intelligence, industry engagement and decision-making

[2] Index is the S&P ASX300 / A-REIT

**Sector based carbon intensity (Ton/US$1m Rev) of portfolio vs index**




Index: S&P ASX300 / A-REIT constituents, 30 June 2024

## Proxy Voting

In the three months to 30 June 2024, Resolution Capital voted on 168 resolutions at 13 shareholder meetings and voted against 7 resolutions. Note that in all cases where we intend to vote against resolutions, we communicate our rationale to the company ahead of the vote.

| Proxy voting overview | |
|---|---|
| **30 June 2024** | **Vote statistics** |
| Meetings | 13 |
| Resolutions | 168 |
| Voted For | 161 |
| Voted Against | 7 |
| Shareholder Resolutions | 2 |
| Abstained | 0 |
| No Action | 0 |

## Votes against management

**TERNA (TRN-IT)**

At Terna's AGM this year we voted against management on two administrative resolutions related to the company's financial reports in protest to limits on shareholder rights enacted by the company.

As part of Italy's response to the COVID-19 emergency, there were restrictions on the physical participation of shareholders at a company's AGM, with the shareholder's able to act through a proxyholder. In practice, a company would designate an exclusive proxyholder that all shareholders would be represented by. Terna has elected to extend this restriction through to the end of 2024 and is also not broadcasting the AGM online, therefore shareholders are effectively barred from actively participating in the AGM.

As there is no resolution related to approving these measures, we voted against the two administrative resolutions related to approving the company's financial statements, statutory reports and allocation of income in protest of the company severely restricting shareholder rights to take part in the AGM. We contacted the company to convey our disagreement about this restriction to shareholder rights.

Both resolutions passed, with 99.7% of shares voting FOR these resolutions.

**Dominion Energy (D-US)**

At Dominion Energy's AGM we voted against management's recommendation on a shareholder proposal to require an independent board chair.

Dominion Energy currently has a combined CEO/Chair leadership structure, which we do not view as best practice corporate governance, since this structure can lead to boards not providing sufficient, or effective, independent oversight of company management. The potential need for a transition to this leadership structure is perhaps evidenced by the company's continued Total Shareholder Return (TSR) underperformance.

The shareholder resolution proposed that the company adopt a policy of having a separate CEO and Chair, and that whenever possible, the Chair be independent.

Disappointingly, the resolution only received 34.9% votes FOR and therefore did not pass.

## Corporate engagements

In April we had a call with Equinix, a U.S. Data Centre REIT with a global footprint, focusing on ESG issues including their renewable energy target and energy efficiency measures in its centres.

Equinix has a target for 100% renewable energy coverage of its electricity consumption by 2030, as of 2022 they had 96% coverage (addressing Scope 2 carbon emissions).

Given reports about the dramatic increases in electricity demand caused by the build out of datacentres to house generative AI computing capabilities, we asked whether this target was still achievable. They stated that they had confidence in achieving this renewable energy target given their focus on a different product type to those required by the AI processing activities. This focus is on the retail co-location market, rather than the wholesale hyperscale market. Meaning, they do not tend to see significant increases in energy demand over short time frames. The company sells small portions of datacentre capacity at a time, rather than selling a whole datacentre development in one transaction.

As the company operates in 71 markets, Equinix sources renewable energy in a variety of ways, this can include:

- Supply from local utilities
- Power Purchase Agreements with renewable projects
- Purchasing Renewable Energy Certificates

While utilising all of the above procurement options for sourcing renewable electricity supplies, Equinix prefers additionality in its renewable electricity procurement, as this allows it to have a more direct impact on the expansion of renewable generation capacity. This results in a more direct impact on carbon emissions reduction than purchasing renewable energy certificates from existing generators does.

While Equinix are not seeing many constraints around power supply in their operating regions, most of the constraints that do exist have been political in nature. For example, there are regulations in places like Singapore, Amsterdam and Ireland, where governments have restricted new supply of datacentres due to increasing demand on electricity grids.

On the energy efficiency front, we enquired about the feasibility of increasing internal building or rack space temperatures to reduce the amount of cooling required. The temperatures in these internal areas can increase from the standard 75-85F to 110-115F, theoretically. While this is technically feasible, they have contractual arrangements with their customers to deliver a specified internal temperature.

There is the possibility to negotiate changes in temperatures to be delivered as contracts roll over, however they mentioned that across 10,000 customers and a 3 – 5-year timeframe for each contract, it would take a significant amount of time to roll this out for all of their tenants.

Energy efficiency is something the company has a significant focus on - it is a part of STIs for VP level and above. Their view is that every unit of energy you save in one area is a unit of energy that is available to sell to someone else in that datacentre.

In terms of Scope 3 emissions, Equinix encourages their suppliers to reduce emissions and set a Science Based Target Initiative (SBTi) certified target. They help the suppliers through the SBTi target setting process as well. So far, they've engaged with suppliers representing 66% of their Scope 3 emissions.

Finally, we asked about whether they're facing any constraints due to water scarcity issues and they said that they're not facing any supply issues in the U.S., so far, but it is becoming important in the London, Amsterdam and Frankfurt markets, impacting incremental capacity decisions in those locations.

Overall, given this company operates in a highly carbon and energy intensive sector, there are solid plans to address this and decarbonise operations through tangible actions, ie improve energy efficiency as much as technically feasible, source renewable electricity to cover their usage and collaborate with suppliers to help them decarbonise as well.

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