CROMWELL
PROPERTY GROUP

GREENWASHING: TRANSPARENCY IS EVERYTHING

RESEARCH BRIEFING NOTE
Q3 2023

Climate change is undeniably the most prominent issue that we face today, and from examining the science, the stakes are incredibly high. To avoid the most dangerous and irreversible effects of climate change, we must limit global warming to 1.5 degrees Celsius above pre-industrial levels. Achieving that means carbon emissions must reach net zero by 2050, a significant deviation from the path we are on now (figure 1). The actions companies do or do not take today truly matter.

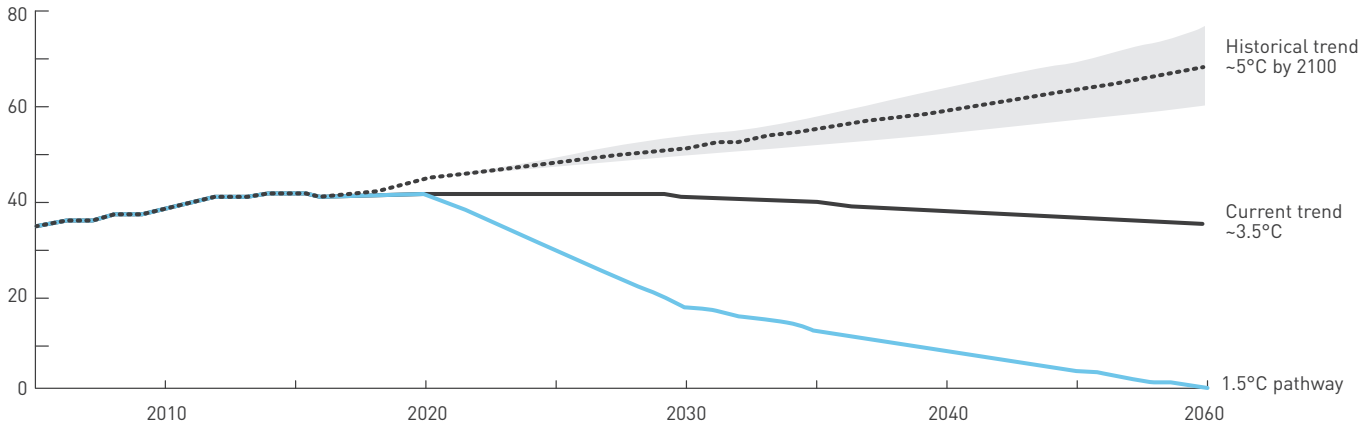
Many companies have publicly declared their environmental, social and governance (ESG) strategies to formalise a commitment to net zero and align to the UN's sustainable development goals. However, if these strategies are not backed up by solid, auditable data and acted upon in a meaningful way, then they are pointless.

Making empty or misleading statements about the sustainability of a company's products or services, whether intentional or not, is known as *greenwashing*.

Incentives: Company benefits

Greenwashing can occur because of corporate ignorance. However, a company may also be incentivised to make its products more attractive to consumers, thereby increasing sales volumes and/or enabling price rises, through greenwashing. It may also assist with attracting and retaining

Figure 1: Projected carbon dioxide emissions (billion metric tonnes of CO2 per year)



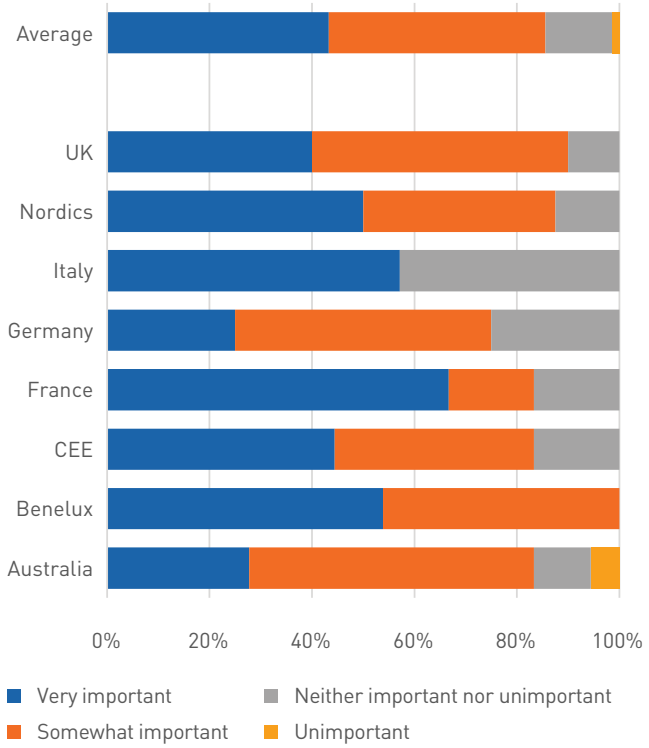
Source: McKinsey & Company, 2021

the most sought after commodity in the modern economy – talent. An increasing number of European employees are attracted to work for companies that value sustainability (figure 2).

Companies with the best environmental/ESG credentials can attract a valuation premium relative to their peers as investment into sustainable and ESG funds increase. In turn, this can lower the cost of capital as their equity attracts a higher price and they need to issue fewer shares to raise funds. The same is true of green debt where lenders are prepared to accept a lower return in exchange for sustainability and ESG targets.

Therefore, making a company appear more environmentally sustainable carries only upside, unless the claims are shown to be greenwashing.

Figure 2: Cromwell staff behavioural survey, "How important is it to work for a company which aligns with your personal views on environmental/ESG issues?"



Source: Cromwell Property Group, Q1 2023

Strategies: Numerous and sophisticated

Deliberate greenwashing strategies are becoming increasingly sophisticated. They range from emphasising a sustainable activity without betraying that the rest of the company's business is environmentally damaging, to deliberately avoiding being an industry leader by moving at the speed of the slowest adopter.

The table below highlights the main greenwashing tactics.

Table 1: Common greenwashing tactics

Greencrowding	Companies adopt a group initiative to avoid having their unsustainable practices spotted.
Greenlighting	Company communications highlight a particularly green feature of its operations or products, however small, to draw attention away from environmentally damaging activities being conducted elsewhere.
Greenshifting	Companies shift the responsibility onto consumers to be more sustainable and reduce their own individual footprint, rather than having to take meaningful action at the corporate or brand level.
Greenlabelling	Marketers call something green or sustainable, but a closer examination reveals that their words are misleading.
Greenrinsing	A company constantly changes its ESG targets right before they are achieved. Companies may also change the parameters and deadlines of previously set-out ESG goals to evade scrutiny.
Greenhushing	Companies choose to not communicate their sustainability efforts to evade investor scrutiny.

Source: Planet Tracker, The Greenwashing Hydra, Q1 2023

Risk: Reputational damage

The risks associated with greenwashing are significant, not just legally due to increasing regulation and the potential for litigation, but perhaps even more important, reputationally.

Even when companies want to make honest claims about the sustainability impacts of their activities, there is still a danger that they could be inadvertently misleading. This can often stem from a genuine lack of understanding of the issues involved. For example, there may be an overt commitment to achieving net zero emissions by a certain date without having a plan of how to achieve that or even a realistic measure of current emissions.

Concerns about the risks linked to greenwashing have led some organisations to move in the opposite direction which has given rise to *greenhushing*.

Numerous high-profile greenwashing scandals have contributed to decreased consumer trust in corporate ESG commitments. This lack of trust is preventing the widespread adoption of sustainable behaviours. A lack of access to the sustainability information of a company is also contributing to decreased public trust.

30%

of people expect ESG claims to have been exaggerated[1]

71%

do not believe that the claim is likely to have been verified or checked by an independent expert or regulator[1]

Even when companies are forthcoming about their ESG commitments, the public is often sceptical. A report by data specialist Sensu describes the effects of greenwashing and how it has negatively impacted consumer trust[1]. According their research 30% of people expect ESG claims to have been exaggerated, and 71% do not believe that the claim is likely to have been verified or checked by an independent expert or regulator. Only 23% of the public take ESG claims at face value, while 14% say they usually disbelieve these claims.

The erosion of public trust undermines the environmental movement more generally. It lowers the benefits to companies of meaningfully investing in sustainability which is a cost whilst reducing their ability to secure higher sales/profile/staff attraction and retention/capital etc. as a result.

1 Sensu, 50 Shades of Greenwashing Research Report, Q1 2023

Regulations: Increasingly demanding

There is an urgent need for transparency and accountability when it comes to ESG-related claims to mitigate the risk greenwashing poses.

Globally, regulators are starting to address the greenwashing issue by identifying the problem in more detail, gathering information and proposing new standardised regulations to enable informed choices.

The EU has implemented a set of regulations aimed at bringing more transparency to the investment market relating to ESG. The Sustainable Finance Disclosure Regulation (SFDR) requires financial market participants, including real estate fund managers, to disclose to prospective and existing investors prescribed information outlining their ESG strategy and performance.

Fund managers must explain how they integrate sustainability risks into investment decisions, the true impact of these decisions on environmental and social outcomes, and whether they are promoting an environmental objective or have a sustainable investment objective. This intends to arm investors with measurable information allowing them to confidently assess those funds that are genuinely aligned with their values.

Funds cannot simply classify themselves as sustainable. They must demonstrate the degree of sustainability and elect to disclose under Article 6, Article 8, or Article 9, demonstrating in each case how they are achieving their ESG goals.

SFDR: Fund categories

- *Article 9* - the highest ESG standard where the fund's objective is to provide a positive sustainable impact, such as actively reducing carbon emissions in line with the Paris Agreement.
- *Article 8* - funds that promote environmental and social characteristics but do not have an overarching objective.
- *Article 6* – funds that may integrate sustainability risks into investment decisions but are not promoted as having ESG objectives.

Whilst SFDR regulations are aimed at eliminating greenwashing, many of the provisions have not been developed with real estate in mind. A major impediment for the real estate sector is the "*do no significant harm*" principle enshrined in the regulation, which considers an investment to be sustainable only if it contributes to an environmental or social objective and does not cause significant harm to the environment or any other social objective. Traditionally, real estate development and operation have had a negative impact on the environment, predominantly due to their indirect Scope 3 emissions which are those arising from a company indirectly such as assets that they lease out to other occupiers. This is true despite industry efforts to mitigate, reduce and as a last resort offset these impacts. However, if ESG is truly integrated into the industry business models, overcoming this traditional dichotomy is one of the key challenges for real estate funds looking to disclose under Article 9.

Conclusion: Robust data & a clear strategy needed

Greenwashing can happen because historically there has been little accountability and because of the deep flexibility of the disclosure frameworks which have allowed companies to determine what ESG means to them. SFDR sets the bar higher by providing a comprehensive framework for ESG focused design, development and investment, enabling the creation of socially and environmentally impactful projects that supersede disparate net zero strategies.

To avoid greenwashing, investors need to emphasise transparency, providing key metrics to give a clear view of what they are doing in the ESG area and where their strategy is heading.

Real estate companies are rightly focusing on ESG as one of their principal performance targets, although financial performance remains paramount. However, as capital values continue to align with sustainable outcomes, investors who take the time to become literate and competent at scaling under these rigid standards, and deliver on them, will benefit from stronger financial performance too.

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