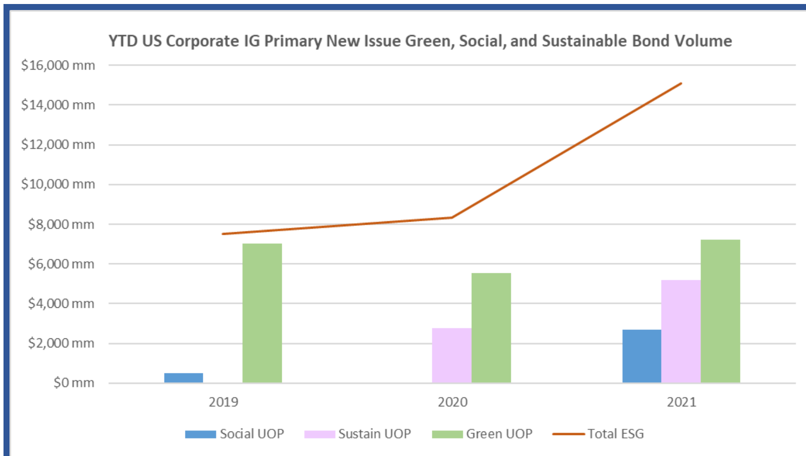
May 2021

Even though the idea came out over a year ago, a report from a German REIT is just now making the rounds. Last year, the CEO of Alstria Office REIT released some interesting findings on real estate, sustainability, climate change, and the financial viability of ESG related projects. In their attempt to assess where they could have greater impact, Alstria found that if fighting climate change is an investor's objective, then real estate might not be the most optimal asset class. This is because their findings revealed that the marginal cost of saving a ton of CO2 is ~81 times higher in real estate than in renewable energy generation.



It was a light month for ESG primary market activity. Total volume was just above ~$2.5bn, supported entirely by social and sustainability themed issuance. There were no corporate IG green bond new issues this April. Both Whirlpool (WHR) and FedEx (FDX) came to market with sustainability bonds totaling ~$1bn. Pacific Life Global Funding (PACLIF) also issued $1.6bn to finance eligible environmental investments and access to essential services like education & affordable housing.

We did some homework of our own, and their report was accurate. After reviewing over 49 green bond reports of US issuers, we were able to find enough data that corroborated the numbers. We found that on average, real estate green bond issuers were allocating an average of ~$85k to mitigate 1MTCO2e. Financials were the second highest sector at ~$8k on average, while utilities paid $218 on average to avoid producing 1MTCO2e. The renewable energy generation sector is clearly one of the most efficient options if you're looking at cutting CO2 emissions quickly from your sustainability report/balance sheet.

The solution the German REIT proposed to address this capital misallocation is a "green dividend". The green dividend would be a small increase to the company's already existing dividend. In practice, if the company would like to make an investment that may yield sustainable results but is less financially viable, it could propose a shareholder vote on the dividend increase. If a majority of shareholders feel that the project is not suitable, they can vote to accept the dividend increase (green dividend) and the full dividend would be paid to them and the proposed sustainable project would not be funded. However, if the majority of shareholders feel that the project is viable and an efficient means of deploying capital, they can vote to deny the dividend increase and the company retains that portion of the dividend to be spent on that project. The company will report back to investors on the project at a later date via disclosures.

It is an interesting (and creative) idea to say the least, but in the end, we have to ask if this is possible in the US and what good could it do? From a corporate financial policy standpoint, it could face some hurdles. The first being that direction would have to come from the Board of Directors, which typically sets dividend policy for US corporations. While not impossible, it will be difficult to get buy-in on something so theoretical until there are more companies exploring this idea as an option.

With respect to the answer to the second question regarding the good that can come from this, the authors of the thesis feel that a green dividend provides more opportunities for investors to choose where capital is allocated outside of companies' mandates/return hurdles as it relates to ESG/sustainability. However, it doesn't guarantee that if the green dividend is paid to an investor (and not retained by the company), that it ever gets allocated to a sustainable project by the investor! Another drawback they do not mention is that it adds another layer to an already logistically intensive investor outreach operation, and increased responsibilities for CFOs and investor relations teams. Lastly, if one could issue a green divided, could there also be a social dividend? Or a sustainable divided? For example, similar to how the ICMA has their green, social, and sustainable bonds and linked loans, could this dividend policy also be replicated?

The situation where we feel a green dividend could be beneficial to both companies and investors is in an ecosystem where a carbon tax is present. In such an instance, if the tax savings/credits on CO2 emissions control is high enough, investors could theoretically lobby the company to forgo the dividend increase and allow the company to invest the capital (earmarked for the incremental green dividend) in their proposed project to reduce carbon tax exposure. If the analysis shows that the incremental EPS gain from the tax savings is more attractive to investors than simply receiving a dividend increase, then this is something a Board of Directors/company might consider.

Ultimately the German REIT's research raises some interesting points (notably on the vast disparity in cost per annual tCO2e saved), between real estate and renewable generation assets. This is something investors may want to note as they look to decarbonize their portfolio—and which investments are likely to provide more "bang for their buck." As for REITs, there are a couple of ways to still leverage renewable energy generation. One option is incorporating increased use of renewable generation on their properties as well as to engage in PPAs. Additionally, REITs could even look to utilize utility scale energy storage that would allow them to replace any onsite emergency diesel generators and could be used to arbitrage electrical rates!

It remains to be determined if the green dividend concept gets any real traction, but the "efficiency disparity" remains and continues to show the maturing attitudes, creativity, and criticality in ESG investing.

Further Resources

Green Dividend Page: https://green-dividend.com/

Responsible Investor Article: https://www.responsible-investor.com/articles/the-ceo-s-perspective-surely-it-s-more-responsible-to-tell-the-truth-than-to-come-up-with-net-zero-claims