TWO SIDES OF THE STORY: GREEN DIVIDEND

actiam

Caspar Snijders

Portfolio Manager Equities

Dear Ruud,

After the shareholders had defeated a motion by the sustainable real estate company Alstria last September, they then actually went on to adopt an identical motion this past May. The motion was about 'green dividends'. The shareholders could either agree to the green dividend, of 1 cent per share, being paid out or else have it invested by Alstria in green solutions that did not, per se, achieve the return objectives. This most recent vote was the first time we'd seen a green dividend. From the shareholders' perspective, this was a mix of normal return and an investment in the energy transition.

Alstria's introduction of the green dividend stemmed from the marginal profits that are available from making existing and new-build property more sustainable in relation to CO_2 reductions. Making buildings more sustainable does not make huge returns for each invested euro when you're considering CO_2 reductions. The real estate projects that Alstria had identified cost €29,000 for every tonne of CO_2 savings.

Other projects that do not involve real estate can save, on average, 1 tonne of CO_2 for every €350. Alstria felt that this discrepancy was too great, so it was a good reason for getting the shareholders to vote on the issue.

The distribution of dividends generally means that a business is short of options for investing the money efficiently and profitably enough. Alstria said it could invest this money, but not in standard investments and also at what would be lower (albeit properly sustainable) rates of return.

This was to be offset against returns, even though it was 1 cent per share or 2% of the dividend, that an investor would be receiving.

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So what happens if you translate this to the global stock market? How much money could in theory be generated with this each year for scaling up investments in the energy transition? Say we take 2019, when total global dividends amounted to €1.21 trillion; 2% of that would release €24.2 billion for investing in green projects.

From the investment perspective, opting for a green dividend will always be predicated on whether the projects being financed are still actually profitable. It will be a very significant factor, despite lower dividends, that the standard return objectives might not be achieved but that the projects are profitable and add value for a business.

If a business uses green dividends to start investing in loss-making projects, simply because it has to invest in green projects, it would make more sense from an investment perspective to get the dividend paid out and then invest it in other businesses that can invest profitably in similar projects.

If Alstria, a real estate company, suddenly starts building wind farms that are loss-making because it doesn't have the requisite expertise, surely it would be better to spend the distributed dividend on listed wind farm developers with a profitable track record?

It seems to me that, from a sustainability viewpoint, we should be celebrating initiatives like the green dividend. What I'm interested in is finding what others think about businesses like this.

Is a company that operates a green dividend just that much more green as a result?

Regards, Caspar

Ruud Hadders

Responsible Investment Officer

Hi Caspar,

Alstria's initiative of offering shareholders the option of investing the dividend in sustainability is a good step forward. The green dividend offers companies a unique resource for reducing their ecological footprint at minimal expense. It can also generate a positive dynamic that other companies might pick up. This type of information should in theory let investors create more structured green capital allocations.

But the fact that the marginal costs of being more sustainable are higher than the benefits, even for the real estate sector with its long-term focus, also really rubs salt in the wound. Olivier Elamine, Alstria's CEO, says that the green dividend is partly a reaction to government failure to introduce a CO_2 tax that would reflect the costs to society of climate change. Elamine argues that companies are then faced with the question of "whether we have to do more than what would be economically sensible?".

Legislative failures are evident from, for instance, the draft report by the high-powered Intergovernmental Panel on Climate Change (IPCC), leaked last month and due for publication this summer. The report confirms that current measures to reduce greenhouse gas emissions are falling a long way short of preventing large-scale climate disasters, even in the near future.

The report, which ended up in the hands of the French press agency APF, is one of the most serious and forceful warnings that the IPCC has issued yet. This is particularly evident from what they term the 'tipping points'. At these tipping points, global warming will have passed such a critical level that the result will be an inevitable domino effect, with catastrophic consequences. If the earth warms up by 1.5 degrees, the Arctic permafrost will melt, releasing methane from the thawed subsoil. Methane is a powerful greenhouse gas and will in turn make global warming even worse.

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The impact of climate change on the real estate sector can be considered under two headings: physical risk and transition risk (or regulation risk). Physical risks relate to the damage to buildings through extreme weather conditions that are inevitable due to climate change. Companies like Alstria therefore have to account for the impact of climate change in their risk models; these can vary from one geographical location to another.

Transition risks refer to the consequences for businesses if, as a society, we manage to restrict global warming to some extent, for instance through tighter legislation. With global legislation as it currently stands, however, we are still a long way from achieving the Paris Climate Agreement targets.

Research by MSCI seems to show that the transition risk is therefore really quite limited for the real estate sector. Less than one percent of corporate value in the real estate sector is affected by the current legislative situation worldwide in relation to suppressing emissions from buildings. In other words, companies like Alstria are largely off the radar and it is private initiatives that will have to take up the slack to force any real change.

Using dividends for initiatives to reduce CO_2 can make an important contribution here. That said, the climate problem is so vast that this would be just a drop in an increasingly sized ocean. The big question is therefore how the business case for greater sustainability can be improved in the absence of a CO_2 tax, so that Alstria can reduce emissions in its core operations and truly turn itself into a greener company.

Regards, Ruud

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