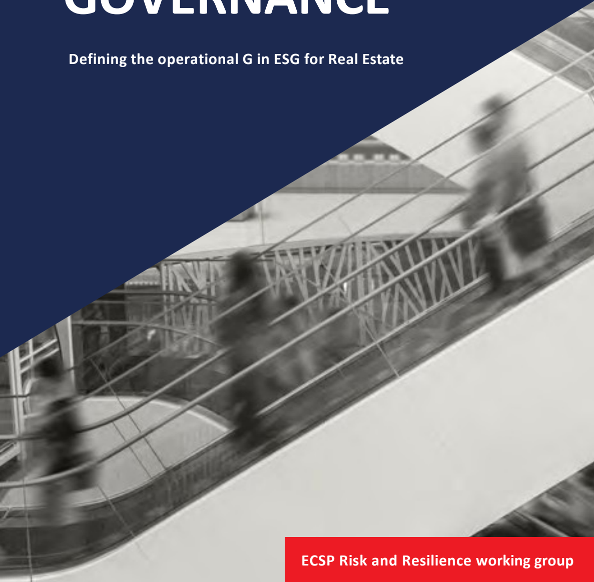
OPERATIONAL GOVERNANCE

Defining the operational G in ESG for Real Estate



ECSP Risk and Resilience working group

ECSP - THE EUROPEAN COUNCIL OF SHOPPING PLACES

The European Council of Shopping Places (ECSP) is the voice for the European retail real estate sector. Based in Brussels, we represent an industry that employs over 6.3 million people, generates 750 billion € in annual turnover, and welcomes billions of visitors each year. Our Members design, develop, and manage vibrant shopping destinations that are essential to the fabric of European communities. We advocate for policies that support the sector's growth and resilience, while providing our Members with essential insights and networking opportunities.

The ECSP Risk and Resilience working group
The European Council of Shopping Places, provides a European platform through the risk and resilience working group to further support the industry in a volatile retail real estate risk environment where human, property, and environmental safety are priorities for any responsible organization. ECSP will, through the working group, take ESG into consideration as an industry measure and ensure a focus on operational risk, resilience, and security.

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DEFINING THE OPERATIONAL G IN ESG FOR REAL ESTATE

Objective
Clarifying the industry challenge to understand and define the operational governance of real estate operations and the strategy for managing operational risks, highlighting the connection to the 'G' in ESG as a crucial aspect of corporate governance.

Reference group from the ECSP Risk and Resilience workgroup

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ESG - ENVIRONMENTAL, SOCIAL, GOVERNANCE

ESG refers to environmental, social, and governance factors that investors use to evaluate their investments' sustainability and governance impact. Good governance supports a culture of accountability, the fair and equitable treatment of shareholders, creditors, and other stakeholders' interests, and addresses issues that could affect the long-term performance of the business. It contributes to the alignment of company purpose, strategy, and values and ensures a commitment to high standards of business integrity and oversight of a supportive corporate culture. It is the bedrock of sound management of sustainability risks, opportunities, and long-term value creation.

Therefore, good governance is an enabler for companies to contribute to a more sustainable world. Corporate governance traditionally focuses on board composition and independence, shareholder rights, remuneration, and annual accounts and audits.

However, there is often a gap between corporate and operational governance, which can lead to strategic goals disruption, operational risk, and potential financial and reputational losses for owners and investors. Therefore, it is imperative to establish sound and reliable governance practices for every organization.

As companies continue to expand their services, grow, and evolve, focusing on efficiency in risk management and developing an effective control environment become crucial. The creation of comprehensive and supportive governance, risk, and control frameworks should be a top priority for all responsible organizations.

Strong operational governance should be viewed as a framework and a process meant to prevent risk exposure or diminish operational risks' impact.

Ultimately, implementing effective operational governance, risk, and control frameworks will facilitate the process for owners and investors to control their operational risk and create actual value.

Simply managing governance through contracts and legal delegations is not enough.

Full operational transparency on investments at both the asset and portfolio levels is necessary to manage risk effectively.

OPERATIONAL GOVERNANCE AND OPERATIONAL RISKS: A CLOSER LOOK

Operational Governance

Operational Governance refers to the key operating decisions made by executives and managers and the follow-through on the execution of policies and standards. It is the implementation of the framework for real estate managers to improve how decisions are made and carried out, contributing to a better organization for any real estate business. E.g., **Maintenance Standards:** Setting procedures and frequency for building maintenance, cleaning, and 3rd party suppliers to ensure safety, compliance, and a positive tenant and customer experience.

Safety and Security Protocols: Establishing guidelines for security management of the property, tenant safety requirements, and security measures such as surveillance systems, guards, and access control.

Operational governance requires a comprehensive understanding of real estate operations and organization. To establish an effective operational governance program, obtaining a firm understanding of the company and a clear view of organizational roles, responsibilities, and ownership is necessary to clarify accountability. The gap between investments with little or no operational oversight and lack of operational governance can be challenging, and investors risk their investments.

Operational Risk

Operational risk is the risk of a change in value caused by actual losses incurred for inadequate or failed internal processes, people, and systems. It can also be caused by external events, such as security, civil unrest, natural disasters, privacy protection, legal risks, physical (e.g., infrastructure shutdown), environmental hazards, or even external partners' failure to perform.

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Operational risks are even higher in real estate where the current complex setup with outsourced services, multiple contractors, and the frequent change of companies for cost optimization create outsourced risks which ultimately can lead to losses for owners at the asset and portfolio levels.

Operational governance can tackle these operational risks through clear standards, implemented policies, risk management, compliance, and periodically tested business continuity arrangements rather than through contracts and delegations. Governance models with multiple stakeholders of outsourced services require significant compliance efforts and an understanding of the setup of operational governance.

To understand this, it takes enterprise-wide knowledge, which a business process-based approach can deliver, and an operational understanding of how it should be implemented in a clear, structured, systematic, well-integrated, and simple way. Operational governance and risk management are crucial for safe and profitable real estate operations. The failure of operational governance is where the most significant risks and challenges are not timely identified and adequately managed.

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Operational risks and human risks

Operational risks are often caused by human factors, including people's decisions and non-decisions, actions, and non-actions that can lead to organizational loss whether financial or non-financial loss. Human Risk can be caused by how an organization manages the safety and protection of individuals (personnel, customers, visitors, partners' personnel, etc.) and by how its partners (tenants, suppliers) manage their own human assets. Furthermore, effective operational risk management requires a comprehensive approach that includes identifying potential risks, assessing their likelihood and impact, implementing measures to mitigate or transfer risk, monitoring risk exposure versus company risk profile, embedding needed controls in business processes, and continually improving risk management processes.

In a nutshell

Real estate businesses face a unique set of challenges when it comes to operational governance and risk management. In addition to the typical risks associated with any business, such as strategic, financial, compliance, legal, and reputational risks, real estate businesses must also contend with risks related to property management, environmental hazards, and physical security.

To effectively manage operational risk in the real estate industry, companies must establish clear risk management policies and procedures, including defining risk profiles, regular risk assessments, and ongoing monitoring of overall risk exposure.

They must also ensure that employees and contractors are trained and equipped to identify and report potential risks

Overall, operational governance and risk management are critical components of any real estate business and should be a top priority for owners and investors.

By implementing effective governance frameworks and risk management processes, companies can reduce their risk exposure, improve operational efficiency, and create value for all stakeholders.

THE KEY TO A SUCCESSFUL OPERATIONAL GOVERNANCE: A RISK CULTURE AND RISK-BASED APPROACH

For operational governance to function effectively in an organization, a strong risk culture must be established through a holistic and process-oriented approach. Every department and level of management must embrace this challenge, with clear accountability assigned to each leader and individual.
This ensures effective risk management, strong operational governance, and the development of a robust risk culture.

The sections below list examples of how operational governance, aimed at minimizing risk and ensuring a safe and commercial environment, ties in to the property operation.

Management system

- Alignment to strategy
- Tone from the top
- Transparency
- Ethics
- Organization

ACTIONS: Establish and maintain policies, procedures, and guidelines for effective management of the asset and ensure compliance with regulations and industry standards (e.g. management policies, such as code of conduct, risk management, data privacy, safety and security policies, and policies for disabled persons. Well-documented local asset organization with clear roles and responsibilities, including all suppliers.

Risk management

- Risk profile
- Risk management framework and processes
- Risk assessment and monitoring
- Risk register

ACTIONS: Conduct regular assessments to identify and analyze potential risks to the asset, stakeholders, and business operations and implement appropriate risk mitigation measures. (e.g. Climate risk assessment, Health and Safety risk assessment, security risk assessment, and business impact assessment.)

Property management

- Safety, security
- Protection of assets and humans
- Maintenance and monitoring
- Supplier relationship management
- Business continuity

ACTIONS: Ensure proper maintenance of the asset, with a focus on life safety systems and functionality, property security systems, and efficient supplier management to ensure timely completion of maintenance and repairs.

Tenant management

- Operational framework
- Communication
- Support and assistance

ACTIONS: Develop and enforce policies and procedures to ensure tenant safety and security and provide guidance and support to tenants (e.g., fit-out process, incidents, crisis management, fire protection, house rules etc.) to ensure safe store operations, including periodic follow-up inside the store premises for inherent store risks.

Visitor management

- Safe interaction
- Accidents and incidents prevention
- Communication
- Privacy protection
- Brand, reputation exposure

ACTIONS: Implement measures to ensure a safe visitor experience (e.g., first aid facilities, clear signage, privacy protection, info point, accessibility, assistance, lost child procedures etc.), including preventing slips, trips, and falls.

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Safety and security management

- Safety
- Security
- Communication
- Brand, reputation exposure

ACTIONS:

- Establish and implement security management procedures and measures for the safe and secure operation of the building, including the deployment of trained security personnel, the development of standard operating procedures, and the implementation of access control measures, cctv and ensure a structured, systematic and well implemented safety and security management system.
- Define crisis management framework, backup plans, and reliable contractual arrangements with essential suppliers.

Business continuity management

- Emergency response plan
- Crisis management
- Business continuity
- Disaster recovery

ACTIONS:

- Define emergency response plan, crisis management, business continuity, and disaster recovery plans.
- Develop and implement plans, procedures, and guidelines to ensure business continuity in the event of an emergency or crisis, including disaster recovery measures for IT and cyber-related incidents
- Learn from experiences to continually improve the plan.
- Deploy periodic testing of existing arrangements, as well as training and awareness programs for personnel.

Strong operational governance will enhance your operational capabilities, build trust and confidence, and increase the value of your properties.

SUMMARY

To ensure successful implementation, it is crucial to have a comprehensive understanding of the business processes and operations. This enables the development of an approach that aligns fully with the company's goals and is quickly adopted by stakeholders.

However, it's not enough to define policies; effective communication is essential to ensure their understanding and implementation. Without clear communication, the risk of failed execution remains.

The "(operational) **G**" in ESG is a crucial factor for business success, and it requires the attention of both owners and asset managers.
By prioritizing and improving governance practices, companies can ensure sound investments and value creation while reasonably and wisely balancing strategic goals with:

- continuously changing political, social, and economic scenario
- more and more demanding legislative trends and regulators' strategic priorities
- increasing focus on environmental preservation
- protection of individual's rights and liberties
- need to increase risk culture awareness among communities.

By setting performance metrics and regularly monitoring progress, operational governance enables leaders to identify areas of improvement and take corrective actions when necessary.

By ensuring strong operational governance and implementing robust monitoring and reporting mechanisms, you will further enhance your operational capabilities, build trust and confidence among your stakeholders, and increase the value of your properties.