

The value of sustainability

Dr. Andy Lewry¹, Mr James Fisher², Mr Matt Holden³

¹ CEng, CSci, FIMMM, CEnv, MSocEnv, FEMA; Principal Technical Consultant, BREEAM Existing Buildings Team, BRE Global, Watford, WD25 9XX, UK; Email: Andy.Lewry@bre.co.uk.

² Team Leader, BREEAM Existing Buildings Team, BRE Global, Watford, WD25 9XX, UK; Email: James.Fisher@bre.co.uk.

³ Economic Consultant, BREEAM - Operations, Management & Strategic R&D, BRE Global, Watford, WD25 9XX, UK; Email: Matt.Holden@bre.co.uk.

Abstract:

As the market place becomes increasingly competitive and there is a need to be able to differentiate oneself as a high performer. From Andrew Vaughan the CEO of Redevco 'Greening our portfolio over the next two years is not only environmentally the right thing to do, it also makes sound business sense.' One of the barriers to this is the result of split responsibilities within the real estate sector.

Buildings built and/or managed to sustainability standards, such as BREEAM have been shown to minimise risk and generate maximum profit via:

- High and continuous rental income;
- Low operating & maintenance cost;
- Low depreciation.

Through certification and verification all parties can be confident in:

- The performance of assets and portfolios;
- It allows comparability across building types and countries;
- The analysis is based on sound science and standards;
- Allows you to be one step ahead of legislation and industry best practices.

*The UK RICS Valuation Sustainability Working Group do not think we are paying a premium for green buildings **but having to give a discount** because the building is not performing well.*

This paper presents the business case and value gained by being sustainable and how certification gives credibility to process and performance of portfolios and buildings.

Keywords: Sustainability; value case; Asset management; Asset performance; Operational performance

1. Introduction

The management of real estate investments is aimed at maximising property value and return on investment [1] via:

- Effective risk management;

- Efficient property management;
- Identification and implementation of valuable improvements.

In the current highly competitive market place the “Challenges for Real Estate Clients” are:

- Increasing profit;
- Maintaining competitive edge;
- Driving asset yield;
- Minimising voids;
- ‘Being the best on the street’;
- High productivity workspaces.

2. What is the value of sustainable buildings?”

An interesting question and all the relevant stakeholders need to be considered as illustrated in Figure 1:

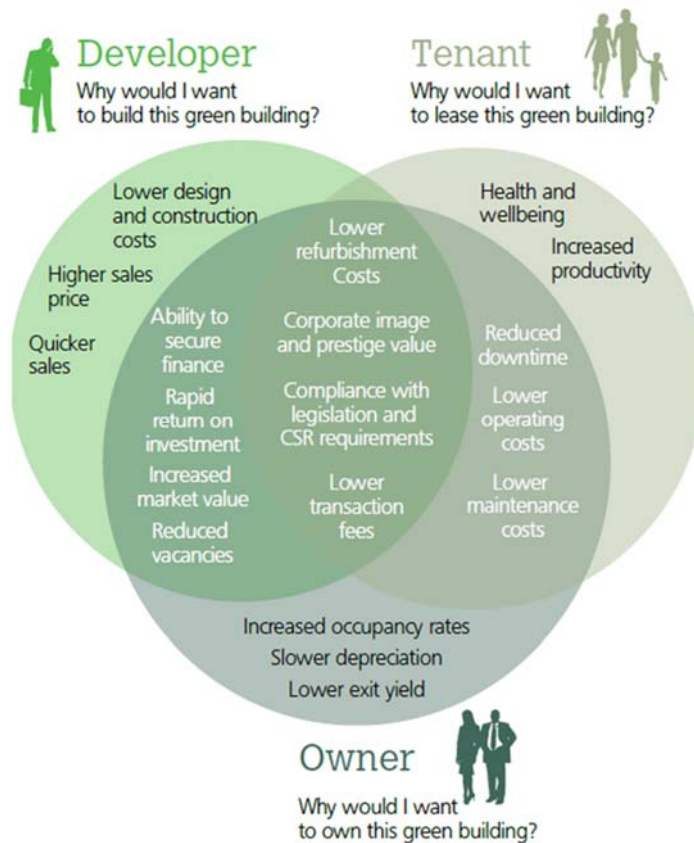


Figure 1. Stakeholders in Real estate asset management [2]

These split responsibilities within the real estate sector and the positions are now being challenged as the valuers now are changing their position from “*paying a premium for green buildings*” to “*having to give a discount because the building is not performing well*”.

3. High performance assets

High-performing buildings provide a solution in that they have been shown to generate maximum profit via:

- Asset protection
- High and continuous rental income
- Low operating & maintenance cost
- Low depreciation.

The increase in rentable value is shown by studies to be a maximum of 25% but an average of between 5-10% is more realistic (see Figure 2).

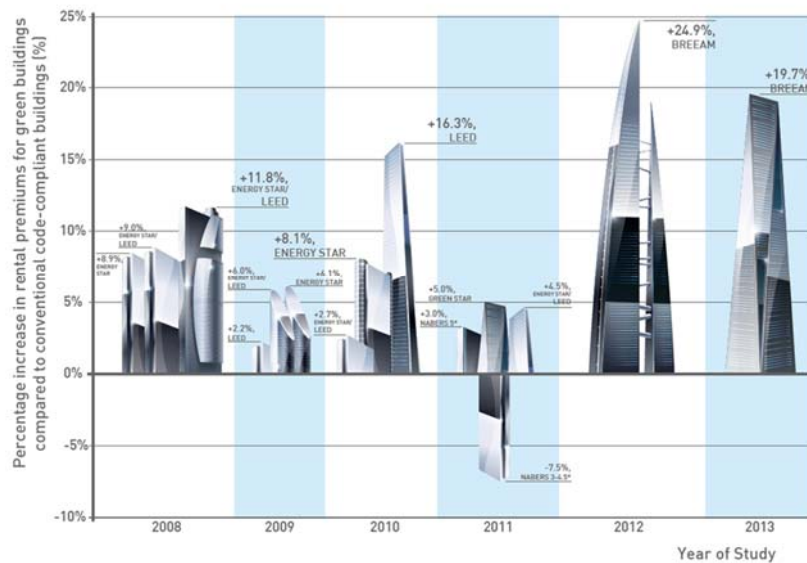


Figure 2. Studies on the rentable value for green buildings [3]

This is further illustrated by the case study below [4]:

Case study: Increased yield with lower risk

From an investment perspective, it also bolstered marketability and reduced obsolescence risk. On launch, we were able to advertise the letting at £65 per square foot – an improvement of some 20% on our expectations when we first undertook the project.’

*Dr Steve Waygood, Chief Responsible Investment Officer
Aviva Responsible investment update, Spring/Summer 2015*



The earlier you engage with sustainable design principles the more chance you have to influence the sustainability of the project at a lower cost – see Figure 3.

At the planning and pre-design stages there are opportunities through economies of scale, site-wide solutions and greater flexibility in design or decisions to be made.

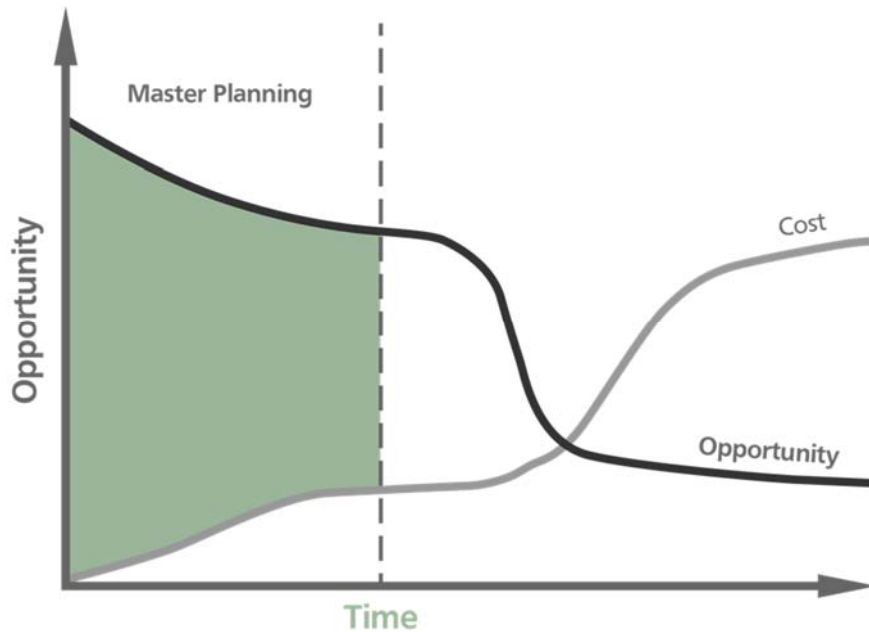


Figure 3. The window of opportunity for high performance design

The benefits of high performance buildings can be realised by the use of certification.

As a process it facilitates:

- Client engagement;
- Communication within project team and between developers and their clients;
- Common language: standards, methods and data flows.

With 3rd party certification it realises the following benefits:

- Assurance for clients, investors & other stakeholders;
- Comparability across building types and countries;
- Based on sound science and standards;
- One step ahead of legislation and industry best practices.

However, you also need to consider the operational phase with schemes such as:

- BREEAM in Use (BiU);
- Non-Domestic Refurbishment & Fit-Out (RFO).

The reason for this are that 80% of the life costs of a building are embedded in the operational phase and generally non-domestic buildings have a design lifetime of 20-40 years. With UK new built being approximately 1% per annum means the majority of the

stock are in the operational phase with its associated costs. Therefore, the opportunities for providing an improved environment for the occupants and lowering running cost are substantial.

However, poor operational management [5,6] undermines the aims of asset management and leads to:

- Increased tenant complaints regarding comfort conditions and loss of reputation;
- Higher service charges;
- Longer void periods leading to a reduction of income;
- Lower and shorter rental values, because of higher service charges and poor comfort conditions;
- Capital expenditure on Heating, Ventilation and Air Conditioning (HVAC) equipment failures, due to poor maintenance;
- Tenants wanting to renegotiate rent values based on maintenance issues.

Again, sustainable certification can be seen to reduce running costs as illustrated by the average reductions shown in Figure 4:

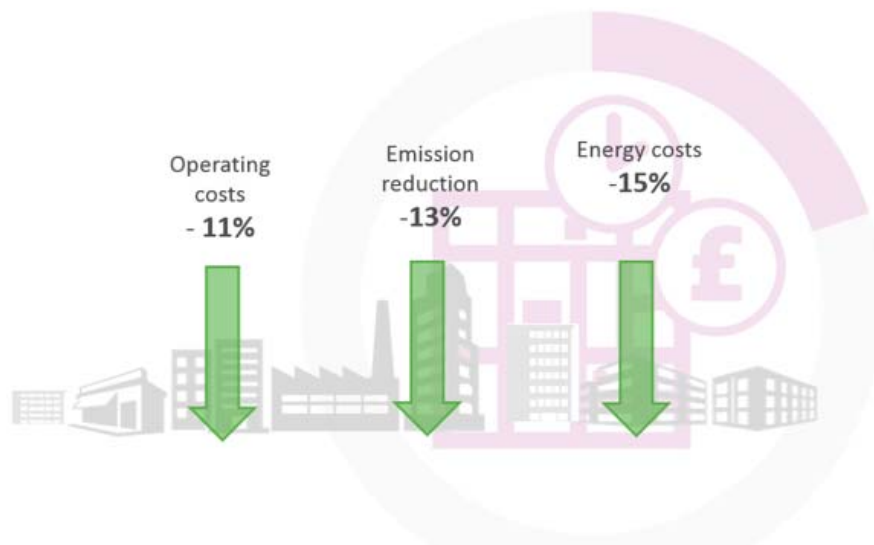


Figure 4. Studies on the operational cost for green buildings [2,3]

4. Conclusion

With sustainability in general and the third-party certification of sustainability becoming more mainstream across institutional grade real estate. In reviewing the latest literature, we have noted a shift in the argument in recent times away from a “green premium” to a “brown discount”, especially within the London office market, that seems to indicate a shift from a developing market for sustainability to a mature market where sustainable credentials come hand in hand with top level assets.

To reflect this ever-evolving issue, BRE is actively engaged with a number of industry partners to update the existing, empirical body of evidence that exists around BREEAM and a link to increased property prices. Over the course of the next twelve months we plan on updating the work carried out by RICS in partnership with Maastricht University “Supply, Demand and the Value of Green Buildings” [7]. In updating, we also aim to broaden the breadth of this work to include evidence and insights into the other factors mentioned above as well as including more lifecycle stages and locations for the first time. We are also actively exploring ways of communicating value to a wider selection of stakeholders by measuring value at a more aggregate level than just looking at individual asset value. We are exploring the feasibility of creating an index of publicly listed companies who have a commitment to BREEAM within their strategy against those who don’t. The methodology for this piece of work is still taking shape but we anticipate an analysis of publicly available data on company value, such as market capitalisation of publicly listed firms. It would then be determined through reviewing company literature on strategy such as Environmental, Social and Governance (ESG) strategies and Annual Reports whether the company has a defined strategy for implementing or investing in BREEAM. We would then compare those that do with those that don’t to compare profitability and market value. If available we would like to explore comparative yields and other measures in addition to the standard metrics.

5. References

- [1] Mind the Gap: Quantifying Principal-Agent Problems in Energy Efficiency, International Energy Agency, 2007, https://www.iea.org/publications/freepublications/publication/mind_the_gap.pdf.
- [2] ‘Towards a greener future’, DLA Piper report, 2014, <https://www.dlapiper.com/~media/Files/Insights/Publications/2014/03/towardsagreenerfuture.pdf>.
- [3] ‘Business case for green building’, World Green Building Council report, 2013, <http://www.ukgbc.org/sites/default/files/World%20GBC%20Business%20Case%20for%20Green%20Buildings.pdf>.
- [4] BREEAM case studies, <https://www.breeam.com/case-studies/>.
- [5] UK Green Building Council Task group report – “Delivering Building Performance”, 11th May 2016, <http://www.ukgbc.org/sites/default/files/UK-GBC%20Task%20Group%20Report%20Delivering%20Building%20Performance.pdf>.
- [6] Innovate UK – “Building Performance Evaluation Programme: Getting the best from buildings - Findings from non-domestic projects”, January 2016, <https://www.gov.uk/government/publications/low-carbon-buildings-best-practices-and-what-to-avoid>.
- [7] RICS research report, “Supply, Demand and the Value of Green Buildings”, March 2012, http://www.breeam.es/images/recursos/inf/informe_rics_supply_demand_and_the_value_of_green_buildings.pdf.