

ROI Increases For Sustainable Buildings

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The movement towards "sustainable" commercial property investment has gathered momentum in recent years, as the issues have captured greater attention from governments, owners, occupiers, and the media. Investors want to see a return for the risk they take in greening their assets, for improving sustainability, and in achieving particular levels of accreditation on the environmental performance of their buildings.

Without a doubt, the most convincing argument to convince real estate investors to continue sustainable investment for commercial property is to show the correlation with returns. Specifically, property owners are expecting to realize higher rentals, greater marketability of their properties, and relative increases in value because green buildings are seen to provide a lower risk to their owners. As the expectations of tenants change on the levels of sustainability that are incorporated into the spaces they lease, those properties that do not meet the required standard might become environmentally obsolete.



The industry has made good progress in developing systems and standards to measure and classify environmental performance. In particular, there are a number of well-established, voluntary, industry-standard measurement and rating tools to record environmental performance. North America's Leadership in Energy and Environmental Design (LEED), Australia's Green Star, and the UK's Building Research Establishment Environmental Assessment Method (BREEAM) all provide ratings for sustainable buildings. Originally created for the design and development stages, these voluntary codes are now adapting their systems to existing buildings.

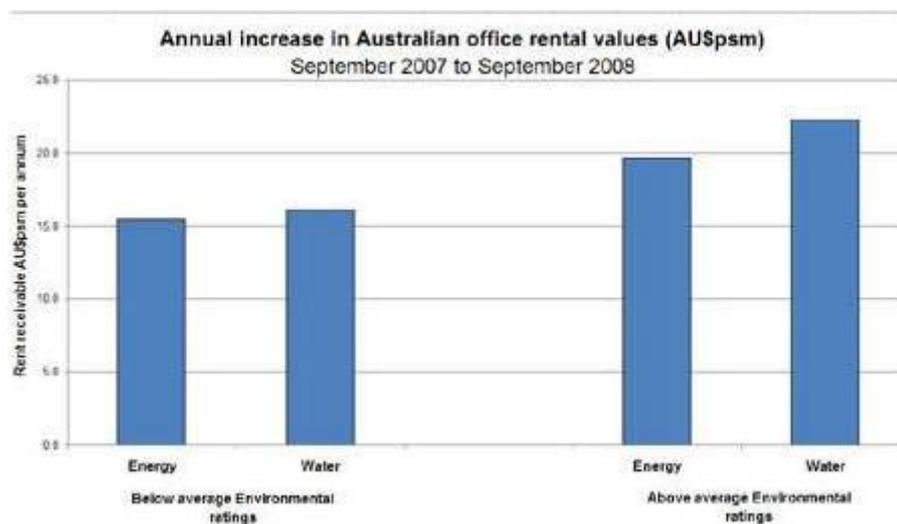
In addition to the certification systems, the [IPD Environment Code](#) provides a consistent, global approach for the classification and measurement of energy use and emissions by the occupier. Similarly, the methodology applied by the National Australian Built Environment Rating System (NABERS) provides a performance-based rating system for existing buildings by measuring operational impacts on the environment relative to other buildings.

The commercial property community has been looking for ways in which to measure, quantifiably, the effect of environmental ratings on the investment performance of their assets and, until now, there has been an absence of independent data to provide this linkage. Most studies have been on an anecdotal or case-by-case basis. Independent benchmarking and market indices would be a step in the right direction to achieve a better awareness of the impact of green buildings on the market, as a whole.

These methods can now begin providing the missing link between green ratings and the investment performance of office buildings. For example, IPD has been able to attribute NABERS energy and water ratings to a sample of 84 office investments in its database, which is derived from the [Property Council / IPD Australian Property Index](#), and to use this sample to provide analysis on the performance of green office buildings in the market. This database holds over 1,000 investments, almost half of which, by value, are offices. The information is compiled from individual, property financial and valuation records supplied directly by the fund managers.

This sample of properties with environmental ratings can be divided into two categories for both energy and water: those with ratings above the market average (3 to 5 stars), and those with ratings at or below market average (0 to 2.5 stars). The findings directly compare rental and capital value performance between lower-rated and higher-rated offices.

Rental values are increasing faster for those properties that have higher energy or water ratings. From September, 2007, to September, 2008, values per square metre increased by \$20 for higher-energy rated buildings compared to only \$15 per square metre for lower-energy rated buildings. The story is similar for water ratings, with values for higher-rated buildings increasing by \$22 per square metre compared to only \$16 per square metre for lower-rated buildings.



With the impact of steep declines in capital value resonating among real estate investors mid-way through the first quarter of, what is expected to be, one of the weakest years for commercial property returns, the performance of rental income will be keenly scrutinised. This is the first direct evidence that suggests that more sustainable offices can provide stronger rental growth than less sustainable offices.

Indeed, the story is similar for capital values over the same 12-month period. The

capital value per square metre for higher-energy rated office buildings increased by 9.2% compared to a 7.5% increase for lower-energy rated buildings. The differential was even more pronounced for the equivalent water ratings, with higher-rated buildings increasing their capital values 13.7 % faster than lower-rated buildings. Vacancy rates are also lower for higher-rated offices based on September 2008 figures.

What does this mean for investors? First, it suggests that property owners are increasingly considering sustainability as an important part of the definition of quality. The result is that owners may be focusing their efforts on improving sustainability on their prime assets to ensure that their buildings are of the highest quality, thus partly explaining why the higher-rated buildings have such higher capital and rental values compared to the rest of the market.

Secondly, it shows that the combination of legislative drivers and tenant expectations is causing a shift in demand in the market. Until the supply of sustainable space increases sufficiently to completely fill this demand, it can be expected that rental premiums are achievable in the short term. Of course, in the medium-to-long term, as green credentials become more commonplace, the question for owners will become, how can they afford not to achieve the ratings expected by market?

The push for greener office buildings has been increasing over the past few years, in a period where property markets, globally, were enjoying robust returns. That the results showing improved performance of green buildings have come through even in the key period in which global markets have turned dramatically, and market sentiment has lurched downwards after the collapse of investment bank Lehman Brothers, highlights the increasing awareness of the value and importance of sustainability in our buildings.

Any market advantage that owners can create for their properties could help to protect them from the volatility in the market. As a greater awareness of green buildings is achieved, owners will focus on attaining better performance from their green buildings, thus promoting the issue of environmental sustainability.

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