

'Investment and Responsible Real Estate'

17th International Land Policy Forum:

Ministry of Land, Infrastructure,
Transport and Tourism

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Past Co-chair - UNEP FI Property Working Group
Chair – IIGCC Property Workstream

- PRUPIM
- Property – a key part of the problem and the solution
- Different Approaches to ‘Responsible Property’
 - Screening
 - Engagement with buildings, tenants and leases
- Evaluating Different Types of Responsible Investment Funds

PRUPIM: a leading, UK property fund manager

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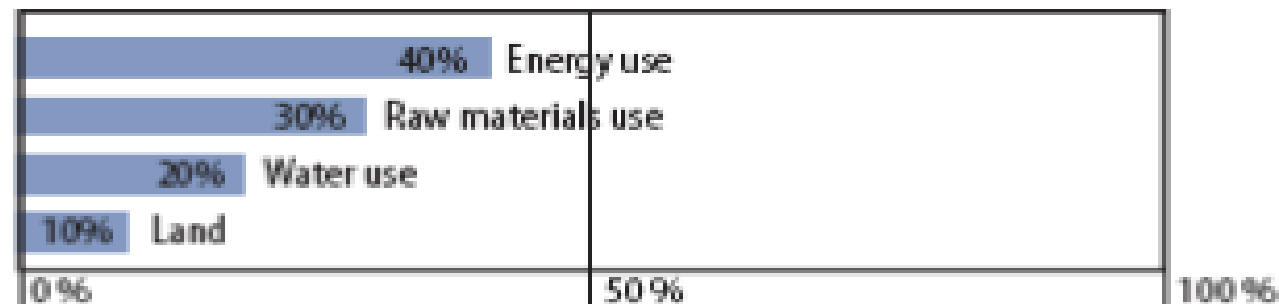
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- **A global property investor**
 - Over £16 billion of property under management worldwide
 - Employing 270 property specialists in London
 - Involved in real estate investment for more than 140 years
- **Fully integrated approach to fund, asset and property management**
 - Unusual in the UK context
 - Scale of the business provides advantage

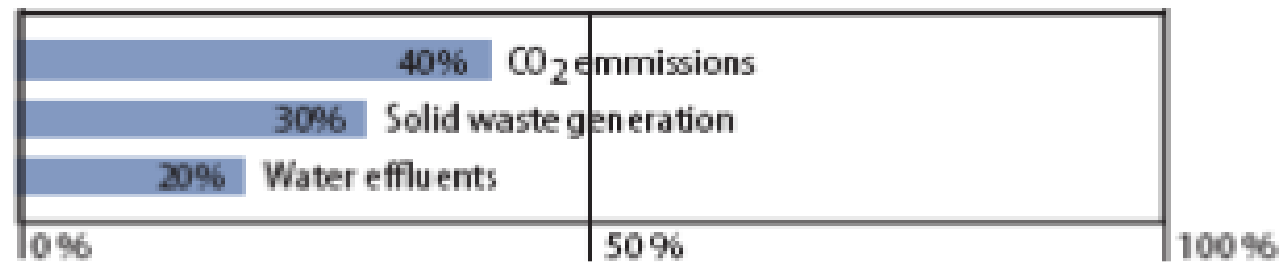
Property – a key contributor to climate change

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SHARE OF THE BUILT ENVIRONMENT IN RESOURCE USE



SHARE OF THE BUILT ENVIRONMENT IN POLLUTION EMISSION



Source: UNEP SBCI, 2006

Property – a key contributor to climate change mitigation

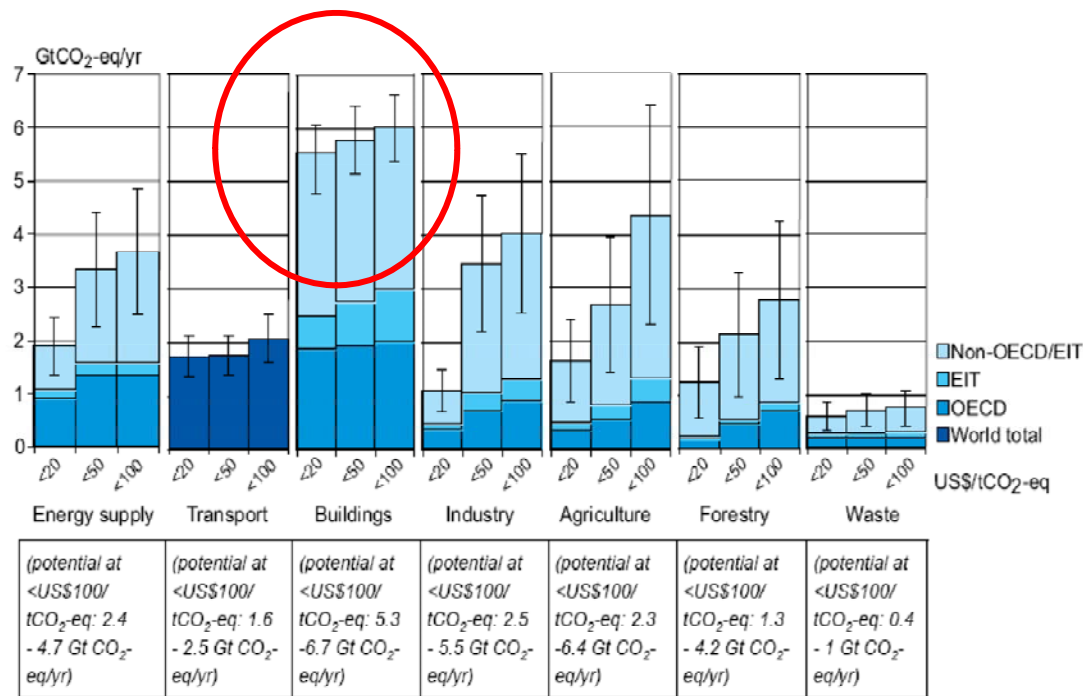


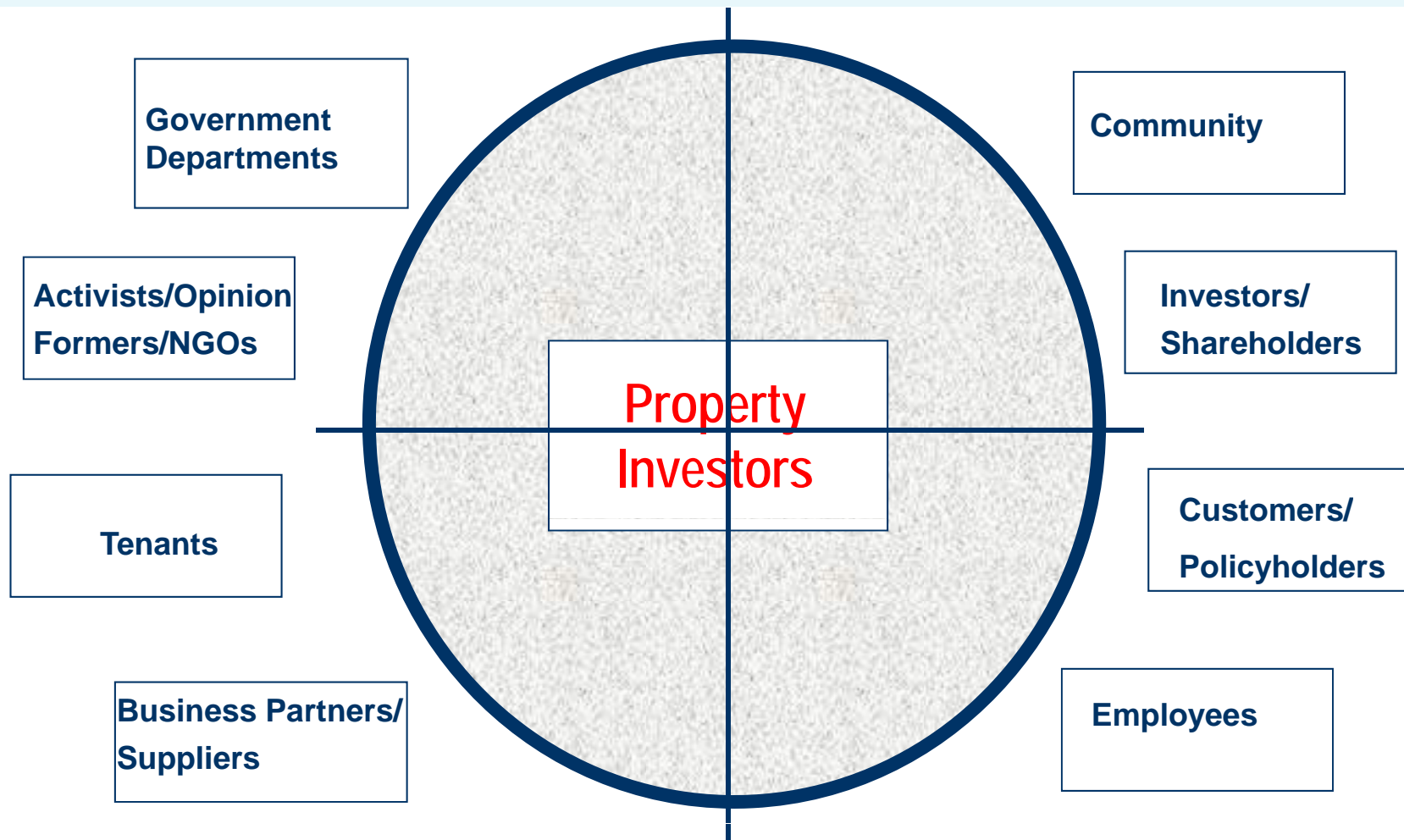
Figure SPM.6: Estimated sectoral economic potential for global mitigation for different regions as a function of carbon price in 2030 from bottom-up studies, compared to the respective baselines assumed in the sector assessments. A full explanation of the derivation of this figure is found in Section 11.3.

“(S)ubstantial reductions in CO₂ emissions from energy use in buildings can be achieved over the coming years using existing, mature technologies for energy efficiency that exist already and have been successfully used.

There is also a broad array of widely accessible and cost-effective technologies and know-how that can abate GHG emissions in buildings to a significant extent that has not as yet been widely adopted. “

Property increasingly in the spotlight

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It's about EXISTING STOCK - not new DEVELOPMENT

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Three possibilities....

**Behaving Responsibly
Enhances Fund
Performance**

**Fiduciary Duty
to act this way**

Can we find a logic
for this?

**Behaving Responsibly
Has No Effect on Fund
Performance**

**“Moral” Duty to
act this way**

Can we find things
to do which do not
affect fund
performance?

**Behaving Responsibly
Harms Fund Performance**

Dilemma

Often the ‘base
case’
assumption...

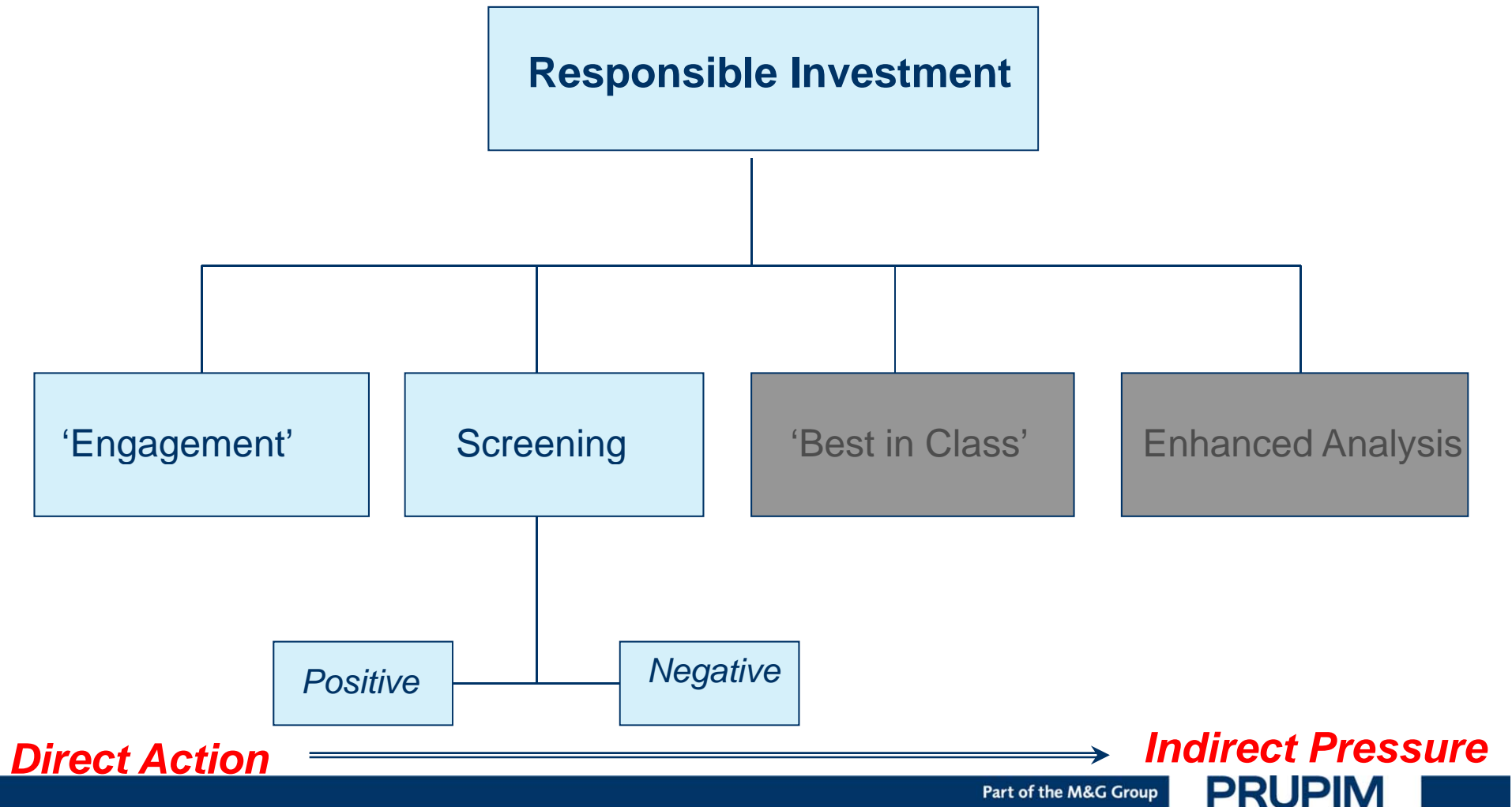


Evaluating Different Approaches to 'Responsible Property Investment'



Forms of Socially Responsible Investment

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Screening can occur through much of the investment process

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Multi-asset,
asset
allocation

Asset allocation
within property

Property stock
selection

Multi-asset, asset allocation

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- In a world of climate change, which types of investment asset will fare best?
- FRR - the hotter and riskier the planet and the global economy gets the lower their allocations to real assets like equities (and to a lesser extent property) are likely to be.



FRR, 2009

“Scenario based framework toconsider a variety of climate change scenarios and map the(ir) potential risks and opportunities ... on asset classes in different regions over the periods until 2030 and 2050. “

MERCER,
late 2010

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Asset allocation could impact the relative attractiveness of property to investors

Screening in property

- By property location
 - *Positive – buy properties near to public transport nodes*
 - *Negative – avoid properties that are dependent of cars*
- By property quality
 - *Positive – only buy/occupy Grade A,B,C buildings*
 - *Negative – avoid Grade D,E,F buildings*
- By property type
 - *Positive – only buy retail and office properties*
 - *Negative – avoid industrial properties*
- By property tenant
 - *Positive – only let to tenants with ‘green products and policies’*
 - *Negative – avoid letting to those involved with armaments, etc...*



Is there an investment logic for
screened property portfolios?



'Green' can have a positive effect on property values and returns

Setting aside the risk of unanticipated Government regulation.....

Factor	Investment Implications	Underlying effects
Tenants prefer green buildings	<ul style="list-style-type: none">▪ Rental differentials emerge between green and non-green buildings▪ Green assets quicker to re-let	<ul style="list-style-type: none">▪ Rental growth higher, depreciation lower▪ Shorter interruptions to cash-flow, lower risk premium
Green buildings are cheaper to run	More money available for rent	Rental growth higher
Other investors prefer 'green' buildings	Green properties quicker to transact	Greater liquidity, lower opportunity cost and risk premium

- Green assets likely to have lower yields, higher values over time
- As differences in value emerge, green assets should outperform

The more it matters, the more values and performance will be affected

Early evidence of possible benefits

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Results for buildings with Energy Star ratings

Variable	Impact of being 'green'
Rent per square foot	+3%
Effective rental income (adjusted for prevailing occupancy levels)	+6%
Sale prices	+16%

- Total sample of 9,998 office buildings throughout the USA – 893 “green”
- 1,816 offices sold between 2004 and 2007 – 199 “green”
- Rental information on 8,182 – 694 “green”

Source: Eichholz P, Kok N and Quigley J (2009) Doing Well by Doing Good? Analysis of the Financial Performance of Green

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Implications for Value and Asset Performance

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- Sustainability will affect the evolution of asset values in the medium term and will, therefore, affect performance
- Sustainability may not be affecting pricing now, but will do in the future
 - (...which means it should be in 'fair value' now)
- The more it “matters”, the greater the impact on value

But screening in property is problematic

- The nature of property causes problems
 - Restrictions to the investment universe creates risk for investors
 - Limited data – on buildings or tenants
- Tenant screening
 - What to do about mixed occupied assets?
 - In UK – not easy to fetter the right to occupy and assign
 - Capital already invested – are you brave enough to wait until an ‘acceptable tenant’ comes along?

Is screening responsible?

- Screening is intelligent but only indirectly ‘responsible’
 - ‘greener’ properties will outperform – (therefore, an intelligent strategy)
 - by directing capital to greener properties, it reduces the cost of capital for ‘green’ assets’ and increases it for ‘brown’ assets
 - Screening passes the environmental problem on – probably to someone with less knowledge than you about what to do with it
- **Successful investors** will understand how sustainability will affect asset pricing and prospective performance and act upon this
- **Responsible investors** will go further and look for economic ways to work with existing assets and tenants to improve their environmental performance and, thereby, protect or enhance future returns



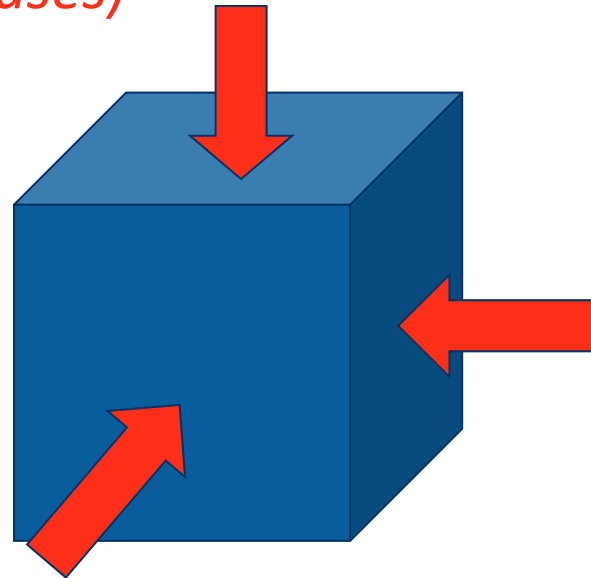
Economic engagement with the building, the tenant and the lease



Three forms of 'Engagement' in Property

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*Engagement with the 'Legal Structure'
(leases)*



*Engagement with the
Tenant (occupiers)*

*Engagement with the Built
Structure (buildings)*

- On Site
 - New building – rare but complete
 - Refurbishment – occasional but meaningful
 - Property management - small but myriad
- “Situation”
 - Travel plans, etc..
- Stop – start
 - Timing, scale and nature of works affected by the lease

Engagement with built structure

Activity and results

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Griffin Industrial Estate Southampton

Aim: differentiate property with improved EPC rating, increase rent achievable, minimise void

Environmental benefit

- Locally sourced, sustainable materials
- Retro fit energy efficiencies to optimise building performance
- EPC rating improved from E to C
- 40% reduction in electricity consumption (anticipated)
- 60 tonnes of CO2 emissions saved p.a. (anticipated)

Economic benefit

- Performance improvements = no cost / low cost
- 50-60% energy cost savings (anticipated)
- No void period or costs
- 13% increase in rent
- 25 bps yield improvement



Before → *After*

'Doing well by doing good'

Engagement - with occupiers

- Occupiers are crucial to the environmental and social impact of a property.
- The lease greatly determines what can be achieved
- ‘Informal engagement’ with tenants
 - No ‘voting’ rights, as in equities
 - Dialogue to persuade or educate tenants how to utilise their premises in a more environmentally responsible way.

Tenant engagement (offices)

Activity and results

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Hollywood House Woking

Aim: retain tenant at lease break, reduce service charge, achieve ISO14001

Environmental benefit

Phase 1 – Initial tenant engagement

- 17% energy consumption reduction
- 100 tonnes of CO2 saved p.a.
- ISO14001 accredited

Phase 2 – installation of highly efficient aircon

- 25% further reduction in energy consumption (anticipated)
- 150 tonnes of CO2 saved p.a. (anticipated)

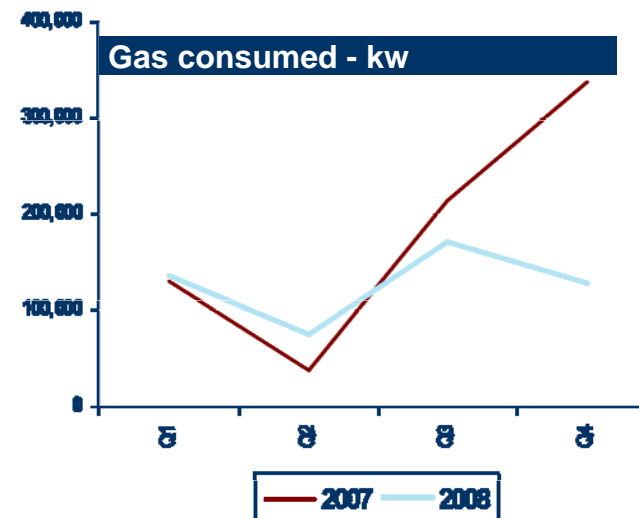
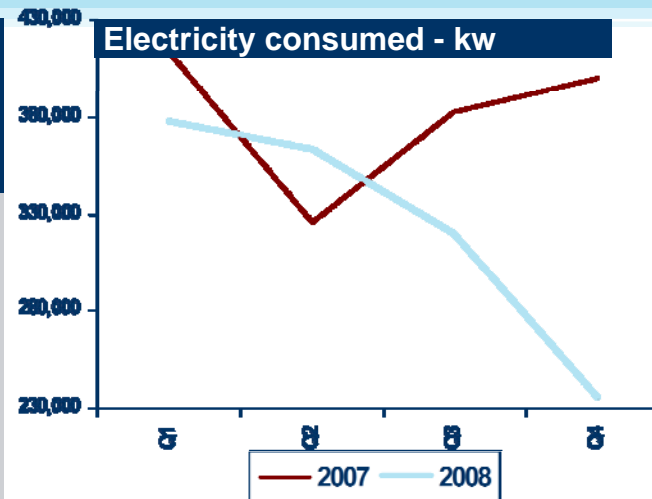
Economic benefit

Phase 1

- 4% reduction in service charge

Phase 2

- Cost of upgrading aircon offset by securing 5 year income for 2 floors
- Improved marketability of anticipated void floor
- Anticipated yield improvement of 50 bps (after costs)



*Doing well
by
doing good*

Retain and attract new tenants

Activity and results

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Shopping Centre Waterside, Lincoln

Aim: retain and attract tenants, reduce service charge, achieve PAS 99

Environmental benefit

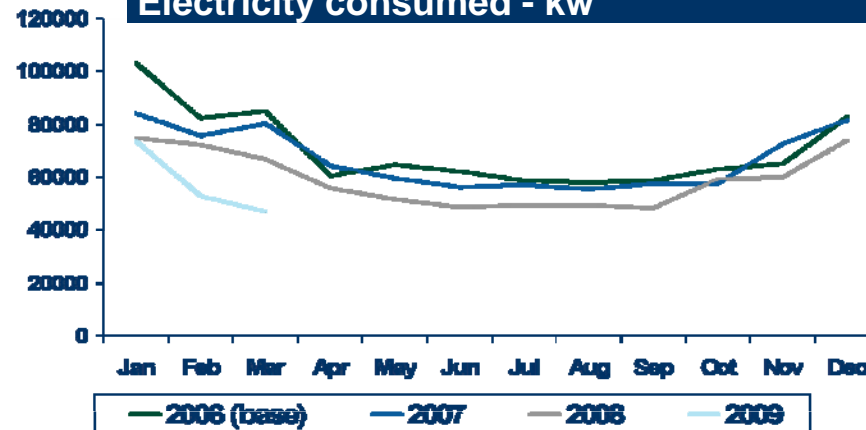
- Recycling from 0% to 44% in a single year
- 30% reduction in waste disposal costs
- Energy efficiency programme
 - 33% reduction in communal electricity consumption
 - 82 tonnes of CO2 emissions saved p.a.
- PAS 99 accredited

Economic benefit

- 5% reduction in service charge
- Exceeded retailers' service charge requirements at lease renewal



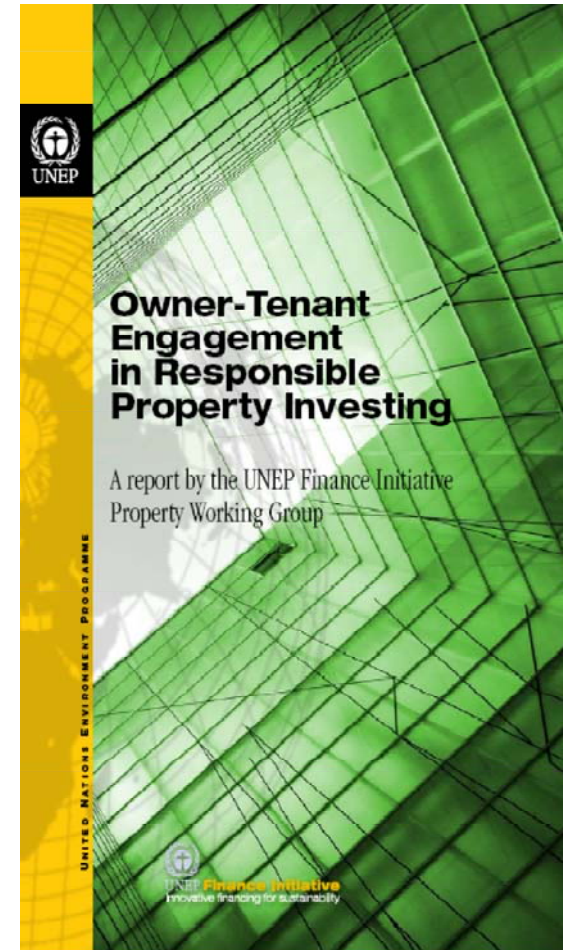
Electricity consumed - kw



Doing well by doing good

“Successful Responsible Property Investment strategies often depend on owner-tenant cooperation. This report presents several stories from leading property organizations that are committed to sustainability and responsible investing on innovative ways to promote better cooperation between owners and tenants.”

<http://www.unepfi.org/fileadmin/documents/TenantEngagementReport.pdf>



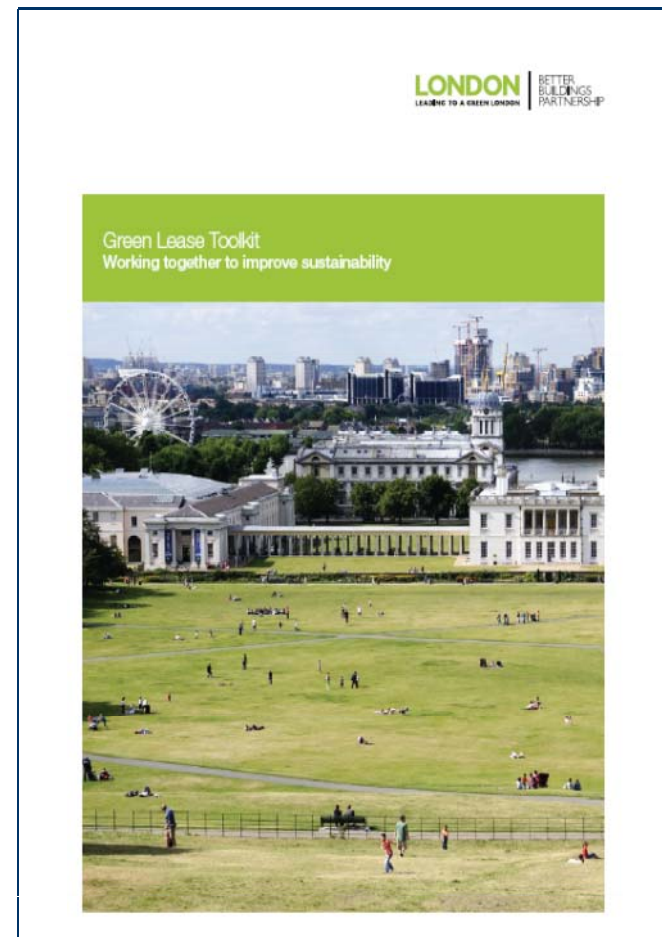
- Green leases/Memoranda of Understanding
 - obligations on both tenant and landlord, agreed at the outset and enforced through the term of the lease.

Engagement – ‘Green Leases’

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“A comprehensive toolkit for green leases to enable owners and occupiers to work together to reduce the environmental impact of their commercial properties.”

<http://www.betterbuildingspartnership.co.uk/working-groups/sustainable-retrofit/low-carbon-retrofit-toolkit/>



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Responsible property investment funds



What forms of responsible property funds are there, and which is best?

<u>Investment approach</u>	<u>Description</u>	<u>Investment Characteristics</u>	<u>Environmental Benefits</u>
<i>Green Development</i> [SCREENING]	Develop green buildings	Risky. Best at specific stages in the property cycle.	Limited. Ensures problems are not exacerbated. Long (environmental) payback period needed to redress the environmental impacts of development.
<i>'Dark Green'</i> [SCREENING]	Buy green buildings occupied by green tenants	Risky. A minute and skewed investable universe which (through inability to exploit market views) could lead to underperformance.	Limited. 'Intelligent' but not particularly responsible.
<i>Improver</i> [ENGAGEMENT]	Buy typical assets, better future proof them and drive their environmental footprint down	Fully diversified portfolios, capable of strategic and tactical management to exploit market views	Makes a positive and immediate contribution to CO2 mitigation

Improver – the least risky and most effective form of RPI

Implementing Responsible Property Funds – the first big question

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- RPI – is it a fund or a style?

- Do we attract capital by having a specific fund?
 - *Q: If this RPI fund is so good for investors, why don't you do it for all your funds...?*
 - *A: Its about focus.....*

- Do we attract capital by being known as a responsible property fund manager that knows how to 'do well by doing good'?

- How long will 'green funds' last?
 - green will become the way we do things rather than something we do.

Conclusions

- Property is a major part of both the problem and solution for mitigating CO2 emissions
-
- Property fund managers need to understand these trends and their impact on value and performance
- Property investors are faced with choices in how to respond
 - Get involved or not get involved
 - Screen or engage
 - New funds or a 'green' management house
- Intelligent investors can profit from this knowledge but responsible investors will strive to '**do well by doing good**' through **improving existing stock**
- Are you going to be a manager of green funds or a green fund manager?