SUSTAINABILITY BRIEFING

A Cushman & Wakefield Business Briefing

SEPTEMBER 2012

IS SUSTAINABILITY REALLY INFLUENCING INVESTMENT DECISIONS?

Sustainability is redefining the balance in real estate investment decision-making. Whether the objective is creating value, reducing cost, or protecting assets against early obsolescence, the combined drivers of regulation and growing stakeholder interest in most markets means that sustainability is increasingly seen as an important commercial consideration in property decisions.

The continuing challenging economic conditions appear to have helped sharpen the focus around sustainability, despite misgivings amongst sceptics.

This report explores the role of sustainability in real estate investment decisions in the UK and continental Europe. In the summer of 2011, we published our first research report on this topic following in-depth interviews with 26 leading UK and European investor organisations. The results painted a picture of a fast changing landscape where sustainability was becoming an increasingly important consideration in investment decisions, despite the lack of quantifiable evidence of the financial costs or benefits associated with this issue.

Our latest report builds on the findings of the 2011 research and provides commentary on how this situation has changed over the last 12 months.

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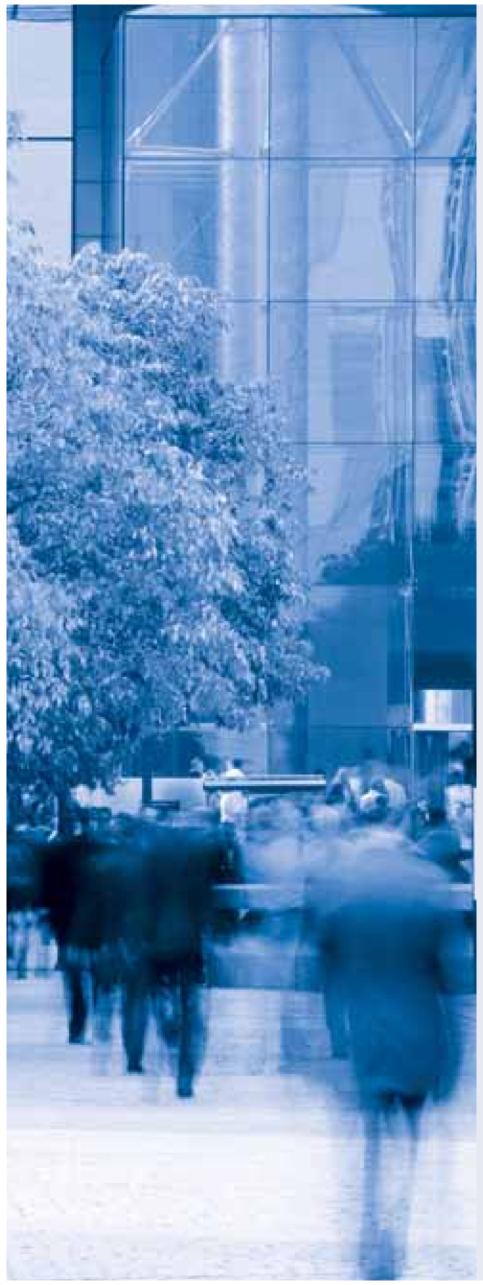
The data in this report was researched independently for Cushman & Wakefield by Remark Research and Marketing. Key decision makers from the following organisations were interviewed during the course of the last two years:



	PARTICIPATED 2011	PARTICIPATED 2012
• Allianz	☑	☑
• APG	☒	☑
• Aviva Investors	☑	☑
• AXA	☑	☑
• British Land	☑	☑
• CBRE Global Investors	☑	☑
• Climate Change Capital	☑	☑
• Commerz Real	☑	☒
• Cushman & Wakefield Investors	☑	☑
• Gazeley	☑	☑
• GLL	☑	☑
• Hammerson	☑	☑
• HDG Mansur Investment Services	☑	☑
• Heitman	☑	☑
• Henderson	☑	☑
• Hermes	☑	☒
• Invesco	☒	☑
• Land Securities	☑	☑
• LaSalle Investment Management	☒	☑
• Legal & General	☑	☑
• Praemerica Real Estate	☑	☒
• Property Alliance Group	☑	☒
• PRUPIM	☑	☑
• Redevco	☒	☑
• Rockspring	☑	☑
• RREEF	☑	☑
• Sonae Sierra	☒	☑
• Standard Life Investments	☑	☑
• SWIP	☑	☑
• The Crown Estate	☑	☑
• Tishman Speyer	☒	☑
• Union Investment	☒	☑
• Westbrook Capital Partners	☑	☒

A combination of structured and open-ended questions were used to capture the views of investment decision makers on sustainability and the extent to which it is incorporated in decision making processes. The results are startling, not because the findings are unexpected, but because of the speed of change over the last 12 months.

The results are discussed in more detail in this document.

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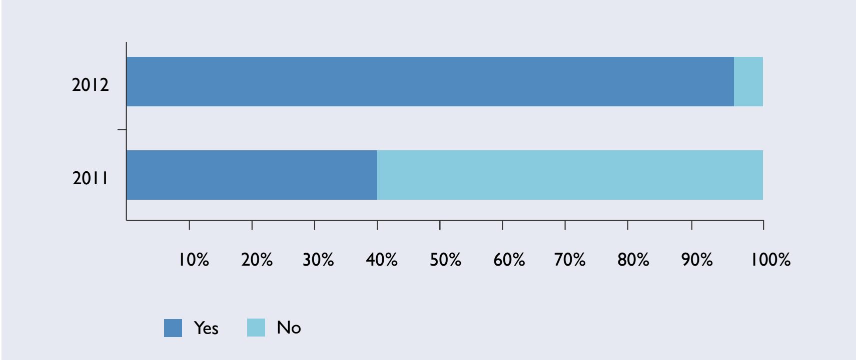
SIGNIFICANT MOMENTUM GAINED AROUND SUSTAINABILITY IN THE PAST YEAR

KEY POINT 1

Implementing a sustainability policy has now become the norm at the fund level.

In the past 12 months, the focus on sustainability by investors and fund managers has gained significant momentum. In 2011, 40% of interviewees said they had implemented a sustainability policy at fund level. This year all but one of the respondents are in the same position and this fund will look to implement a policy by the end of the year.

IS FUND LEVEL SUSTAINABILITY POLICY IN PLACE?

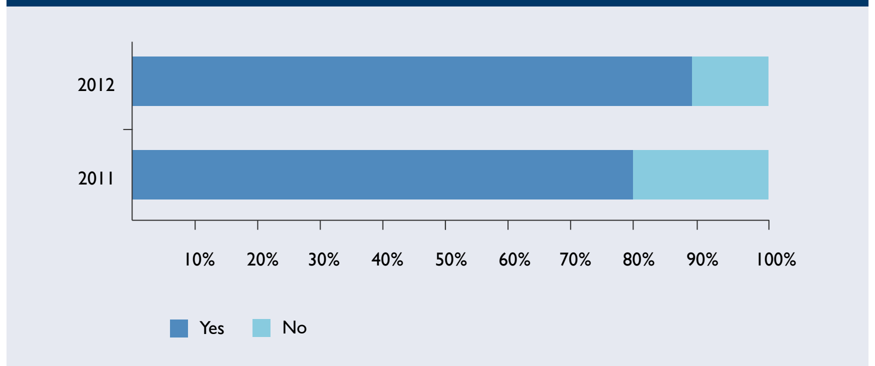


KEY POINT 2

The majority of investors now assess the sustainability of potential acquisitions.

Almost 90% of investors and fund managers we spoke to now have processes in place to evaluate potential new acquisitions in terms of sustainability. This represents an increase of 10% over the last 12 months. Of these, 84% now use a consistent methodology to evaluate the sustainability credentials prior to acquisition of properties.

IS SUSTAINABILITY CONSIDERED DURING AN ACQUISITION PROCESS?



In 2012, **96%** of respondents had implemented a sustainability policy at the fund level, compared to **40%** in 2011

"Sustainability wasn't part of our front fund regulation when we spoke last year, but … we are trying to raise more capital and a different profile of capital and risk/return is a criteria. So we will be putting a sustainability policy in place…"

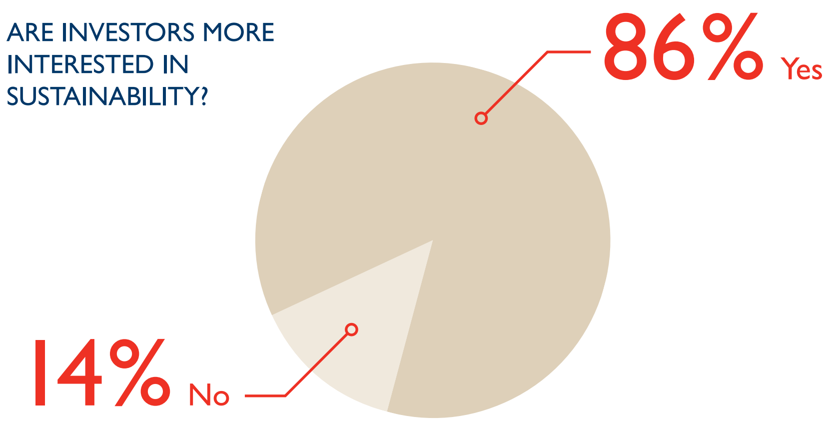
"We are performing a Green Rating Audit on any property we consider for acquisition. Based on those results and all the relevant financials and other criteria … we will make our decision to proceed or not. Sustainability is completely part of the decision making mix…"

KEY POINT 3

Investor and occupier interest drives action.

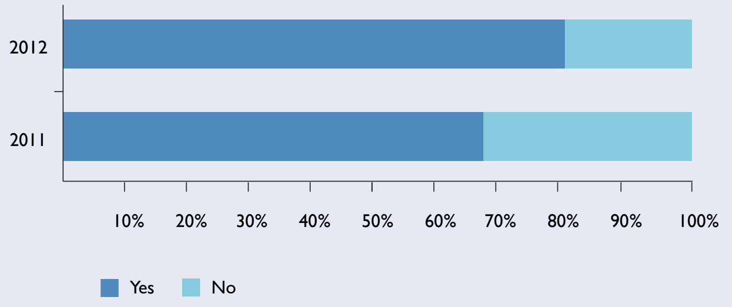
- **Investors:** 86% of respondents report that investors are becoming more interested in sustainability. The continued ability to attract investment and to meet investor requirements for sustainability performance and reporting is the most significant reason for the momentum gained around sustainability amongst investment & asset managers in the last 12 months. This interest often manifests itself in the RFP process, where questions are reported as being more specific and probing. It is no longer a case of being able to pay lip service to sustainability, as investors want to know that actions are now being taken and that this risk is being managed.

ARE INVESTORS MORE INTERESTED IN SUSTAINABILITY?



- **Occupiers:** The majority of respondents (81%) are also seeing occupiers demanding more sustainable space. The demand has been most noticeable in the prime office sector. Unsurprisingly this is where most value difference between a sustainable and non-sustainable building is reported to be.

IS OCCUPIER DEMAND DRIVING SUSTAINABILITY?



"Investors have a lot of questions. The landscape has completely changed over the last 12 months … they realise and understand far better that not being sustainable means a higher risk of obsolescence…"

"Investor interest is the main driver for us at the moment"

"Occupiers are definitely becoming more demanding in that they wouldn't even look at our property if it didn't reach a certain standard. It's more prevalent on offices …"

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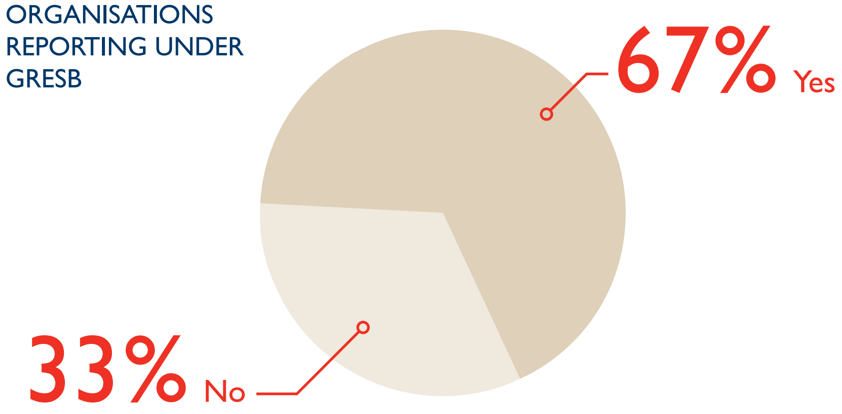
KEY POINT 4

Fund level sustainability reporting has become widespread.

Our research shows that the Global Real Estate Sustainability Benchmark (GRESB) has become an important tool in creating more transparency in the environmental and social performance of real estate investment funds. 67% of interviewees now report on one or more of their funds under GRESB.

Interest from investors is considered to be the principle driver for the significant increase in funds reporting with CSR compliance, PR, political and ethical reasons being cited as secondary reasons for this change.

ORGANISATIONS REPORTING UNDER GRESB



It would also appear that there is a better alignment between reporting and benchmarking initiatives, as is illustrated by the recent partnership between GRESB and the Global Reporting Initiative (GRI). This should further increase the number of organisations reporting and help to standardise practice across the global real estate sector.

"We submitted seven funds to (GRESB) last year, and that was mainly as a result of at least one investor in each fund requesting that we do it…"

"If you want to offer your product to a certain group of investors they want 'proof' of your commitment to sustainability and (GRESB) gives them that assurance"

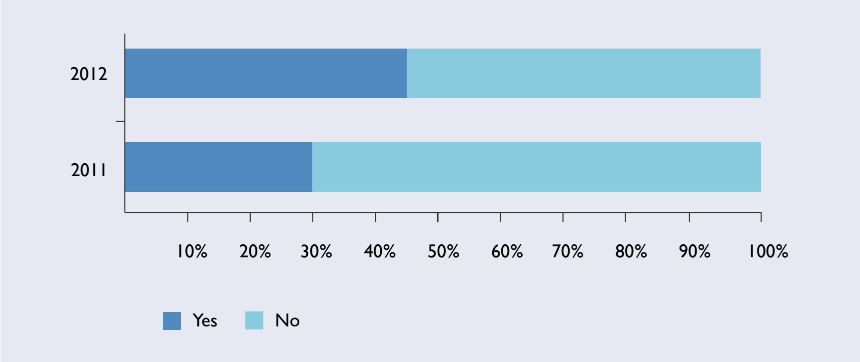
KEY POINT 5

Investors and fund managers are implementing minimum performance standards for their portfolios.

There has been a 50% increase in the number of organisations setting a minimum performance standard for their managed properties in 2012, compared to 2011.

Just under half are now setting reporting standards, but investors are finding that setting standards can be challenging as they are faced with obstacles such as poor data and tenant behaviour. With the increasing focus on fund level reporting and the race for data capture and benchmarking now on, we would expect to see an increase in the setting of minimum performance standards.

ARE SUSTAINABILITY PERFORMANCE STANDARDS BEING SET?



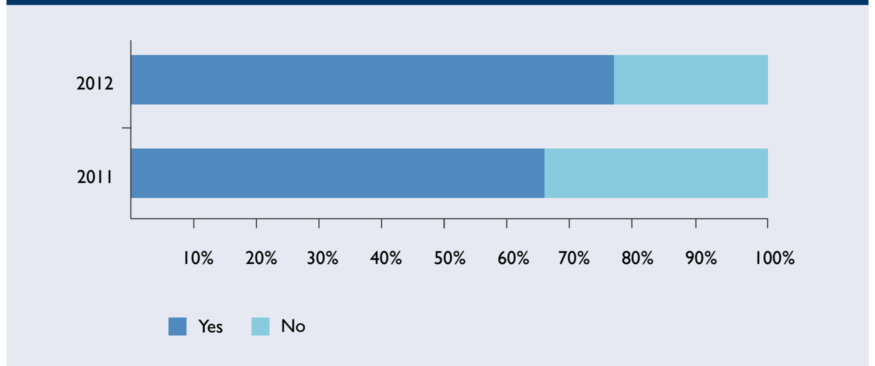
"No we don't have performance standards as such, we have targets to reduce costs across our portfolio. We will eventually set performance standards. It's very difficult when the tenant controls all the power"

KEY POINT 6

Poor sustainability performance is now considered in property disposal.

More than three quarters of the audience (77%) would consider poor sustainability credentials as a contributing factor in the decision to dispose of a specific investment property. This has increased from 66% in 2011.

INVESTORS WHO WOULD CONSIDER POOR SUSTAINABILITY CREDENTIALS AS A FACTOR FOR DISPOSAL



"…All the F & Gs and perhaps even Es are going to require a huge amount of CapEx, which once it starts getting built into business plans some properties will not present as viable investment options"

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Much of this change has been in response to the Energy Act 2011 in the UK. By April 2018 (at the latest) it will become unlawful to rent out a residential or business premise that does not reach a minimum EPC energy efficiency rating of 'E'. The majority of organisations interviewed in 2012 have already started to put steps and measures in place to deal with the expected implications of this legislation. This is also starting to feed into disposal decisions.

KEY POINT 7

Organisations are implementing a dedicated sustainability role.

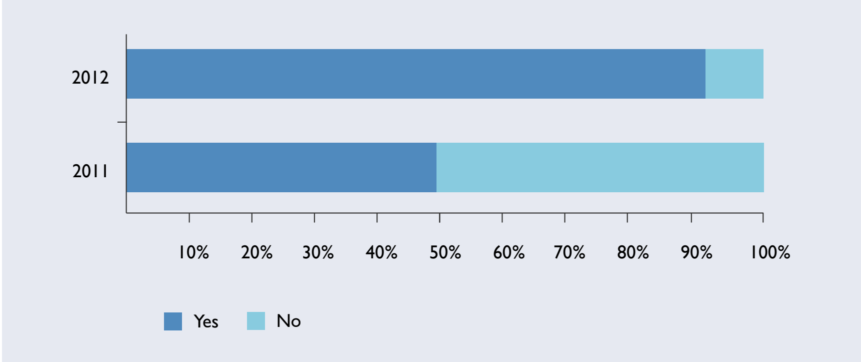
The research has identified a clear shift in how the sustainability function is organised in interviewee organisations. We are seeing many organisations creating a dedicated sustainability function for their funds, and these roles now appear to have a higher profile in investor organisations.

This change is in line with trends amongst major corporates over the last five years, where the rise of the executive level sustainability function, often referred to as the Chief Sustainability Officer, has been well documented.

SUSTAINABLE BUILDINGS – IS THERE A VALUE DIFFERENCE?

The majority of respondents interviewed believe that there is a difference in the value of a sustainable and non-sustainable building. A third of respondents believe that the value differential is more apparent than in 2011.

RESPONDENT VIEWS ON WHETHER THERE IS A VALUE DIFFERENTIAL BETWEEN A SUSTAINABLE AND NON-SUSTAINABLE BUILDING



93%

of respondents believe there is a value differential between a sustainable and non sustainable building

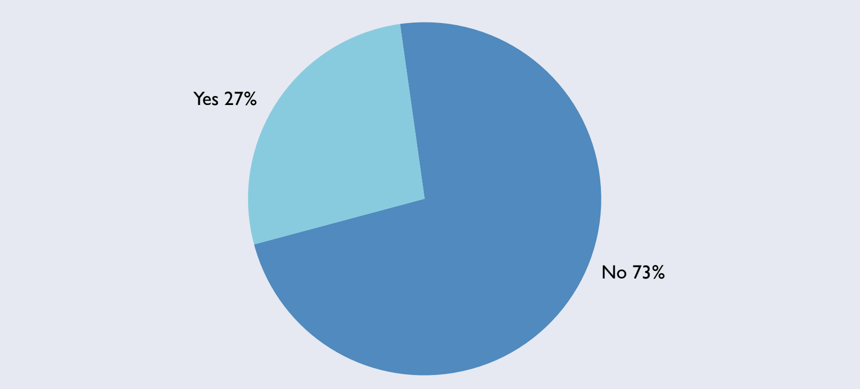
GREEN PREMIUM, BROWN DISCOUNT, OR SOMETHING ALTOGETHER DIFFERENT?

In 2011 we asked those respondents who believed that a value difference existed whether they expect to see this difference manifest itself as a green premium (i.e. sustainable buildings achieving a value/rental premium) or a brown discount (i.e. failure of poorly performing buildings to achieve expected values/rental income). One year on the consensus remains that elements of both are seen, albeit that there now appears to be more widespread expectation that non-sustainable buildings may face early obsolescence.

Only 27% of investors and fund managers saw sustainable buildings commanding rental premiums.

It is widely reported that the most visible signs of the difference between sustainable and non-sustainable buildings are to be found in reduced time spent on the market, and the ability to attract better quality occupiers with stronger covenants.

IS SUSTAINABILITY HAVING AN IMPACT ON RENTAL PREMIUM?



"…We are seeing that all the newer buildings, the ones having some sort of green certification prove quicker to transact"

"Yes, we think there is a value differential between a sustainable and a non-sustainable building…"

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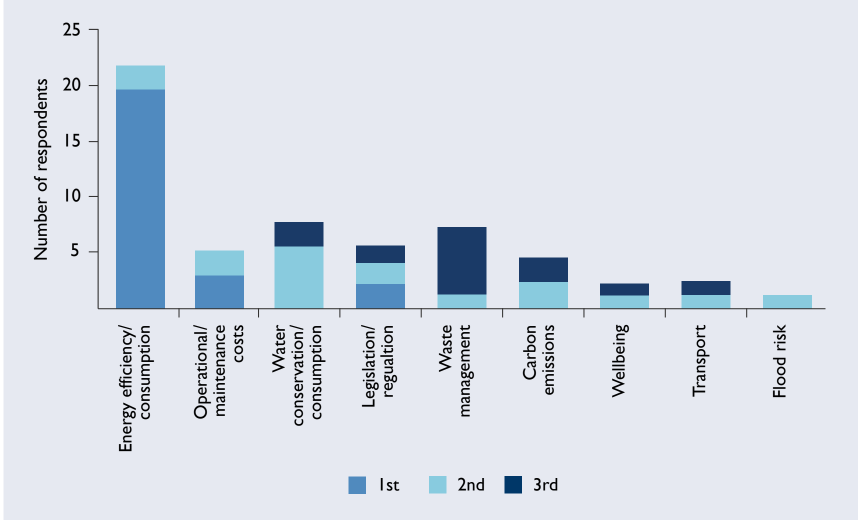
ENERGY EFFICIENCY CONTINUES TO BE THE LEADING FACTOR EXPECTED TO IMPACT VALUE

Respondents were asked to list (in order of importance) those sustainability factors that they felt would have the greatest impact on the value of a specific property. Unsurprisingly, energy performance and utility consumption are seen as the primary drivers for impacting value, although other factors that can be directly linked with operating costs (e.g. waste management, water) are becoming more important.

In addition to the traditional factors identified, several respondents mentioned the link between sustainability, the working environment and productivity. For now, proof of a clear and quantifiable relationship remains elusive. However, should this become provable, sustainability would start to drive value at a completely different scale, as staff costs far outweigh energy costs for most organisations.

SUSTAINABILITY FACTORS THAT IMPACT ON VALUE



"Energy translating into carbon is what is driving the business. If we could add another factor it would be the well-being factor of a building. If tenants feel 'well' in a building then productivity would be higher…"

LACK OF CLARITY AROUND THE SCALE OF IMPACT AND HOW TO QUANTIFY IT

Although there is a widespread acceptance that a value differential exists, the evidence remains largely anecdotal.

A few investors and fund managers report instances where a rental premium was being achieved for sustainable buildings. These premiums are generally most apparent in office space in specific markets such as Australia, USA, the Netherlands and Germany.

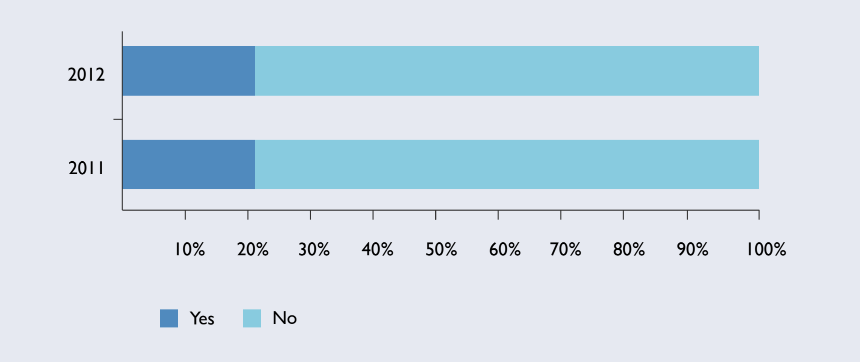
There is a general feeling expressed by various respondents that more concrete evidence of a value differential in European markets is imminent.

ARE SUSTAINABILITY FACTORS BEING INCLUDED IN YIELD CALCULATIONS?

The lack of clarity inevitably means it remains difficult to accurately reflect sustainability in financial decision making. Given the diverse opinions regarding value differential, unsurprisingly less than a quarter of respondents said that they are currently applying adjustment factors to yields to take account of sustainability, this has remained unchanged from 2011.

However, we expect more investors to make attempts to quantify the risk associated with sustainability. Currently, just under 40% of the audience have attempted to quantify the risk to the value of their portfolio. Although this has remained on par with 2011 research findings, more interviewees indicated that they would be looking at this in the next few years. We expect to see some significant developments in this area as investor interest continues to increase, and fund managers seek to future proof their property portfolios.

ARE INVESTORS AND FUND MANAGERS APPLYING ADJUSTMENT FACTORS TO TAKE INTO ACCOUNT SUSTAINABILITY?



"There's evidence in the Netherlands… and in Germany …I haven't seen any peer reviewed evidence in the UK"

"I've heard letting agents say that there is a rental premium for a sustainable building among the big corporates, where I think it is perhaps most evident…"

"It is affecting yields but to what degree is difficult to say...You can't let a building that has zero rental value in 2018 that is really focusing people's mind to it!"

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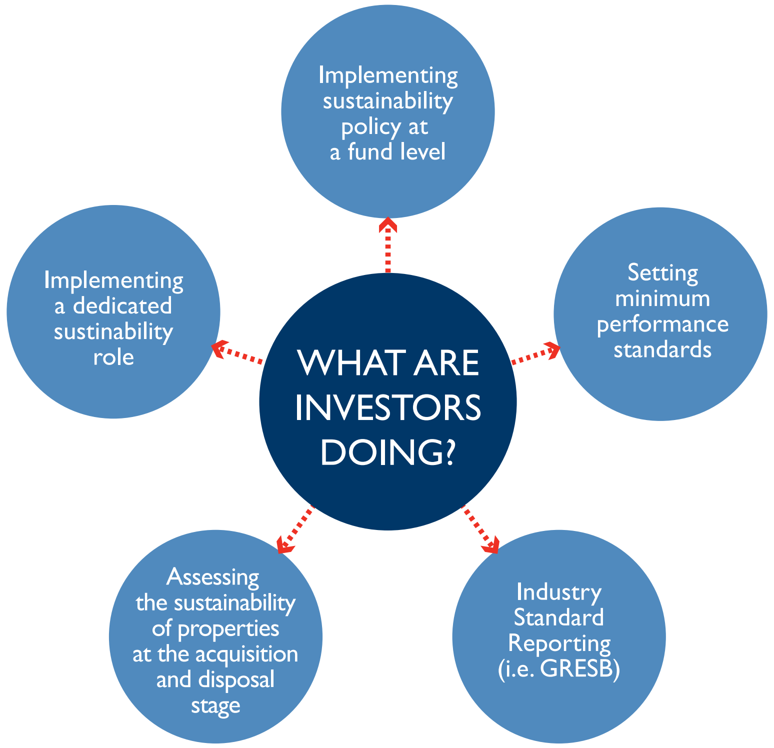
CONCLUSION

On balance, the research highlights the fact that the gradual, and sometimes uncertain, increase in focus on sustainability in the property investment decision-making process over the last few years has changed pace. It has gained significant momentum over the last 12 months, almost to the point where it now feels revolutionary, rather than evolutionary, in nature.



Despite quantifiable evidence of the value impact of sustainability remaining frustratingly elusive in most markets, there appears to be increasing consensus that sustainability delivers added value through properties that are quicker to let, especially in difficult markets, that are cheaper to run and that attract better quality tenants with stronger covenants. When combined with increased pressure from funders, reports of escalating occupier demand in the prime office market, increasing regulatory requirements, and the expectation that energy costs will continue to rise in the future, it is clear that a critical mass has been reached and that the industry now finds itself at an interesting tipping point.

Sustainability is redefining the balance in real estate investment decision-making and, as is often the case, the winners will be those that position themselves best to anticipate and embrace this change.

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