



# THE DEATH OF SOCIAL RESPONSIBILITY IN PROPERTY IS MUCH EXAGGERATED

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## EXECUTIVE SUMMARY

- Climate change and the social and political responses to it are long term in nature and unlikely to be side-lined by short term economic circumstances.
- There is still a tremendous amount that responsible property investors can and should be doing to address social and environmental issues.
- In the current economic climate, the pressures on tenants and property investors to behave in an environmentally and socially responsible manner have not diminished and, indeed, may have increased. With increased energy and other resource costs, it is logical for users of the built environment to reduce consumption, increase reuse and recycle.
- Despite budgetary issues, the political will to tackle climate change is undimmed and the less that governments are able to do directly to achieve their goals, the more they will look to the private sector to help them do so. Given that (a) many believe the tools and techniques for increasing energy efficiency and decreasing energy demand in the built environment already exist; and (b) the potential for environmental gains are huge, the property industry is likely to experience substantially increased attention from governments in the years going forward with respect to the “green agenda”.
- Clearly, if certain actions or equipment cost more or have long payback periods, they may well be avoided in the current economic environment. However, it is too simple to believe that any and all responsible actions cost more. Indeed, the opportunities to make short and medium term cost savings that help environmental goals are manifold and should continue to be sought and implemented by property owners and occupiers.

## **Introduction**

There is a view abroad that the current economic crisis means responsible property investment has become unviable and is currently being shunted down or off the corporate agenda. This brief paper reviews that contention and concludes that sustainability in property and responsible property investment practices generally remain just as important today and potentially more so than when the economy and financial markets were in better health.

## **What has changed?**

The rapid and substantial rise of sustainability in the consciousness of governments, corporates and civic society has been fuelled by widespread and growing concerns about the long term implications of climate change on the functioning and well being of our planet. This has, in turn, triggered extensive enquiry across the globe into the means by which future climate change can be mitigated or how human activity can be adapted to better cope with it.

Under growing government pressure and the critical eye of a burgeoning array of concerned stakeholders, the users and owners of property have taken substantial action in recent years, voluntarily or otherwise, to play their part in addressing what they perceive to be a collective global problem.

If responsible property investment is somehow now in retreat, which of the original drivers have switched into reverse? In what follows, we critically review whether there has been any real diminution in the pressures on property investors and occupiers to act, and whether the market logic behind investing responsibly in property has been changed by current property market conditions.

Finally, the paper examines whether it is necessarily the case that “sustainability costs more and can, therefore, no longer be afforded” or whether, in today’s difficult economic

conditions, the sorts of cost reducing measures that have accompanied much of the thinking on sustainability to date have become more rather than less important.

### **No let up in the political drive**

Looking at the main external driver pushing the industry towards more responsible property-related activity, there seems little evidence of any softening in the desire for governments around the world to pursue a “green agenda”. While it may be true that governments are experiencing competing and urgent pressures on their own time and resources generally, their position remains one of not relenting in the pursuit of greening their economies. Rather, there is increasing recognition that gratuitous excess and waste can not be allowed to continue and that there is economic opportunity in the burgeoning imperative of addressing climate change.

It may be the case that governments have less money to spend on speculative developments in green technology. However, if this is so, it will likely result in them placing increased emphasis on securing their promised environmental goals through “lean tech” approaches to problems like carbon mitigation. It is clear that managing energy demand down and increasing energy efficiency offer relatively easy, cheap and material steps towards meeting promised governmental environmental targets. It seems equally clear that the less able those same governments are to generate or drive green solutions themselves, the more they will pressure others, like the property industry, to achieve their targets for them.

The significance of the built environment to resource usage and CO<sub>2</sub> and other emissions, and the relative ease with which it can be managed to make substantial environmental gains (especially given the growing evidence that many cheap tools and technologies already exist to do so) means that it is far more likely that governments will increase rather than decrease the pressure on property related businesses in the medium term. Property remains a (if not “the”) natural prime target for policy action. Furthermore, in this economic climate, it seems very plausible that politicians could well “kill two birds with one stone” by also

seeking to raise revenue from environmentally damaging activities and assets like energy inefficient properties.

Thus, given that governments have not “gone soft” on sustainability but are less able to deliver directly on the issue, it seems that the external pressures on property-related businesses to behave responsibly are more likely to rise rather than fall in the medium term. Even if they wanted to, the time that governments have already spent on the design and delivery of new environmental legislation and regulation (plus the collective opprobrium that would ensue) precludes any likely relaxation or retrenchment in their efforts to combat climate change.)

### **Enhancing returns, reducing risks and eliminating cost**

Like the main external, governmental driver, the main “internal” investment drivers behind responsible property investment and occupation are also unchanged and are as follows.

Much of the appeal of sustainability to corporate entities relates to simple matters of efficiency and the elimination of waste and related costs. This is just as true in respect of property occupation as in any other industry. However modest, in difficult economic times like today, investment managers’ will turn their attention to finding cost reductions or delaying operational capital expenditure. Much thought and ingenuity is currently being given by corporate managements around the world to squeezing out operating costs and enhancing returns wherever the opportunity arises; lowering energy, water and waste costs through improved housekeeping and better management habits are all aspects of this. In today’s economic, those already doing such things should feel under relatively less pressure than those who have done little to date.

Similar arguments arise when we look at the property investment dimension of sustainability. We have already noted that tenants and investors are under increasing pressure to respond to (and, very often exhibit their own genuine concerns about) the environmental and social impacts of the properties they occupy and invest in. This is steadily leading them to favour “green” over “non-green” properties when renting and

investing. The development of green building labelling systems (BREEAM, LEED, Green Star, CASBEE and others) for new and existing buildings is making this easier for tenants and investors to exercise their preferences in this respect. The most prominent exponents of these trends to date on the occupational side are the growing number of governmental bodies that will only occupy the most sustainable properties. However, they are being accompanied or followed swiftly by leading national and multinational companies, with smaller enterprises sure to follow.

The exercise of these preferences will clearly impact the risk premium and depreciation rates that investors apply to prospective investments and will potentially, if not already priced in-, impact the value and the subsequent investment performance of those assets. For example, if tenants prefer to lease green buildings then the depreciation rate on non-green buildings will rise as their achievable rents fall behind in relative terms. Similarly, the risk premium for non-green properties should also rise because such buildings take more time to let up or transact than their green counterparts.

So, if markets are truly about choice and it is the exercise of that choice that leads to non-green assets underperforming their green counterparts going forward, should we not naturally expect this to be especially the case at the bottom of a market cycle when tenants and investors can exercise the greatest choice about what they decide to let or own?

The impact of sustainability on asset pricing and performance will more likely be exaggerated than diminished in today's difficult property market conditions and, as such, it would surely be counterproductive for investors to relax their focus on sustainability issues at this stage in the market cycle.

### **Maintaining reputation**

Probably the most self-serving reason that property-related and other businesses have to behave responsibly is that of avoiding reputational risk and criticism for acting contrary to prevailing social norms. As such, in the face of the growing evidence of the harmful effects

of climate change, it seems unlikely that any company would want to be seen to “back-pedal” materially on sustainability, irrespective of the economic climate.

Furthermore, asset owners are going to put increasing pressure on their investment managers to ensure that their own reputations are not sullied by inappropriate investments or actions made on their behalf. Given the obvious environmental impact of properties, particularly commercial properties, this will be especially so for property fund managers.

The increasing transparency brought about by the widening range of building standards, disclosure practices and measurement regimes can only reinforce this. Even in this economic climate, responsible developers and investors will still want to continue to be seen to develop high standard buildings and reduce the environmental impacts of existing assets. They will not welcome being seen as “quitters”.

### **Ask not what sustainability can do for you....**

We have shown above that there are strong reasons to believe that the desire to occupy and invest in property in responsible ways has not become less relevant simply because economic circumstances have deteriorated. However, we need to go further and explore the notion that sustainability is now slipping down the agendas of investors and corporate entities because it “costs more” and, in the current economic climate, rational actors can therefore do less of it.

Whilst appearing intuitive initially, this argument overlooks three things. First, not “everything” a responsible property investor or occupier might do costs more. Indeed, an extensive and growing literature exists to show that there are many responsible things can be done to better manage the environmental impacts of property assets that either cost the same or less than “ordinary” activities. Poor economic conditions generally should not be used as an excuse not to take such opportunities to reduce the environment impact of existing buildings or new constructions.

Second, such an argument also depends on tenants and investors being unwilling to pay extra for the inclusion or existence of sustainable features in a building, if they are economically viable. Clearly, if demonstrably attractive paybacks arise as a result of lower running costs in the face of rising energy and other resource cost, or though enhanced business and worker performance (commonly associated with greener buildings) then such investments should still be pursued. There is a view that the association of “sustainability” and greater cost’ is, in any event, now more perceived than real. If tenants are asked whether they want a “sustainable building” many, even now, will respond “no” because of an embedded belief that such a property will cost more to rent and run. However, if asked whether they want lower running costs, more daylight, better views, higher productivity, healthier staff and better amenities, tenants would answer differently.

Third, and in any event, responsible property investors and occupiers should always be turning the cost-benefit equation upside down to establish the (many) responsible actions that can be implemented at low and no cost. For example, by eliminating inefficiencies in resource use and cheap to set up, energy, water and waste management systems generally show a rapid pay back and ultimately increase the total return to a property portfolio. In difficult market conditions , such practices increase rather than decrease in importance.

Clearly, where actions and equipment relating to sustainability do cost more then, in hard times, they will be avoided. However, this must not blind anyone to the substantial contributions responsible property businesses can make to carbon mitigation and efficient resource usage that are financially viable. Nor should it obscure the ingenuity of businesses in developing skills and processes to increase the universe of cost-effective solutions. In both cases, difficult economic conditions are not a justification for not trying.

### **Conclusion**

The pressures on tenants and property investors to behave in an environmentally and socially responsible manner have not diminished. Indeed, if anything, they are likely to have increased in these hard times. While other economic issues are clearly grabbing today’s headlines, the importance of behaving responsibly remains undiminished.



Similarly, the business logic surrounding the responsible occupation of, and investment in, property remains firmly in place. Indeed, given the atmosphere of cost consciousness and the enhanced choice that exists in today's tenant and investment markets, such a logic is potentially at its strongest.

Furthermore, the political will to tackle "green" issues has certainly not diminished. Arguably, the less that governments are able to do directly to achieve their goals, the more they will depend on others to achieve them. No industry is likely to feel this increased level of attention more than property where the general perception is that the tools and techniques for increased energy efficiency and decreased energy demand already exist but are insufficiently applied, and that the potential environmental gains from such actions are perceived to be significant.

Climate change and the social and political concerns and responses to it, are long term in nature. As such, they are unlikely to be side-lined by short term cyclical economic crises, however bad they may be. Clearly, where forms of action and equipment do cost more, they will be avoided in the current environment. However, it is simply not the case that all responsible actions cost more. There is still a tremendous amount that a willing and responsible property industry can and should be doing to address sustainability related issues, even in these difficult economic times. The current economic malaise is not a reason to stop trying. Our world is too precious for that.

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