Sustainability and Property Value

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ERM
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- **Director Sustainability & Climate Change**
  - 20 year’s experience
  - Working for large corporations
  - Energy Efficiency focus

- **ERM**
  - 3400 Consultants Worldwide
  - Offices in Johannesburg, Pretoria, Durban & Cape Town
  - Huge expertise in buildings

- **Director of Sustainability Peel Holdings**
  - Privately-owned
  - $10bn Assets
  - Office, Retail, Airports, Ports
Rapid Change

• “Credit Crunch”
  • Financial constraints
  • “Flight to quality”
  • Brutal focus on fundamentals

• Big changes coming
  • Buildings 40% of all GHG’s
  • Ambitious Targets being set
  • Energy expensive, supply risky
  • Tenants aspirations changing

• Huge practical implications
  • Portfolio Strategies
  • Asset Management
  • Valuation
There is a “Sustainability Dividend” though the use of Environmental Science and Solutions to create and enhance Real Estate Asset Value.
Irrefutable evidence

- **CoStar studies**
  - Energy Star certification adds 6% to the rental value and 16% to the capital value of office buildings
  - LEED certification increases sale price by an *additional* 9%
  - Absorption rates higher i.e. vacancy rates lower

- **Green Property Funds are growing**
  - Billions to invest
  - Green certification key

- **Green Building Council (Australia 2008)**
  - Increased market valuation – 10%
  - Increased rental – 5-10%
  - Higher relative investment return – 14% ROI
  - Improved occupant productivity – 1-25%
Irrefutable evidence… (cont).

- **USA Building Owners and Managers Association (2008)**
  - Over 60% of owners got a positive return on investment from green initiatives

- **Jones Lang LaSalle research (2007)**
  - 50% respondents willing to pay 5% premium for sustainable buildings and 25% willing to pay 5%-10% more.

- **GVA Grimley (2007)**
  - 79% of respondents in finance and business services willing to pay more for green building

- **Innovest - USA Real Estate Investment Trusts (2006)**
  - Portfolios demonstrating greater efficiency deliver 15% better share performance and attract a 10.4% market premium
“Where sustainability characteristics are recognised as having an impact, these are to be built into the calculation … particularly where the instruction is to prepare an investment worth valuation.

Sustainability issues could impact future performance and if this is anticipated, they may be incorporated into any discounted cash flow appraisal, with due consideration given for aspects of uncertainty.”
Multiple effects

- Sustainability affects value in many ways
- RICS spells out some of the considerations
- Formal incorporation into the next edition of the Red Book (Jan 2010)

RICS VIP 13:
- Comparables
- Yield
  - operating cost = net income
  - attraction of tenants = voids
  - legislation = decreasing refurb cycles
  - external benefits (some investors)
- Rental Growth
  - Increase energy/water $ = lower rent
- Obsolescence & depreciation
  - some things cant be fixed in refurb!
- Risk
- Exit yields and residual values
- Duration to sale / let
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Simplified Valuation Effects

- Increased Rent
- Decreased Energy Cost
- Lower Refurbishment Freq
- Attractiveness Value

“Green Lease”

Tenant Benefit

- Rent
- Service Charge
- Admin Cost
- Vacancy
- Depreciation
- Net Income
- Market Value

Other benefits: decreased insurance costs, reduced admin costs etc
## Worked Example

<table>
<thead>
<tr>
<th>Valuation</th>
<th>Normal Building</th>
<th>Sustainable Building</th>
<th>Impacts</th>
</tr>
</thead>
<tbody>
<tr>
<td>Usable Floor Area</td>
<td>2,000</td>
<td>2,000</td>
<td></td>
</tr>
<tr>
<td>Rental per m2 month (3)</td>
<td>20</td>
<td>21.2</td>
<td>6% increase via Energy Star</td>
</tr>
<tr>
<td>Energy savings (Serv Charge)</td>
<td></td>
<td>0.8</td>
<td>10% saving (£1.5m2) shared with tenant</td>
</tr>
<tr>
<td><strong>Total Rental Value</strong></td>
<td>480,000</td>
<td>508,991</td>
<td></td>
</tr>
<tr>
<td>Less Admin Costs</td>
<td>31,506</td>
<td>28,355</td>
<td>Assume 10% reduction in admin cost</td>
</tr>
<tr>
<td>Less vacancy costs @ 5%</td>
<td>24,000</td>
<td>21,600</td>
<td>Assume vacancy reduces 10%</td>
</tr>
<tr>
<td><strong>Net Rent (income)</strong></td>
<td>424,494</td>
<td>459,035</td>
<td></td>
</tr>
<tr>
<td>Less Interest on Site Value</td>
<td>34,500</td>
<td>34,500</td>
<td></td>
</tr>
<tr>
<td><strong>Net building Rent</strong></td>
<td>389,994</td>
<td>424,535</td>
<td></td>
</tr>
<tr>
<td>PV 80 years at 5.75%</td>
<td>17.19</td>
<td>17.19</td>
<td></td>
</tr>
<tr>
<td>Value of Building</td>
<td>6,703,997</td>
<td>7,297,764</td>
<td>9%</td>
</tr>
<tr>
<td>Value of Site</td>
<td>600,000</td>
<td>600,000</td>
<td></td>
</tr>
<tr>
<td>Sustainability Increment (5%)</td>
<td></td>
<td>394,888</td>
<td></td>
</tr>
<tr>
<td><strong>Total Market Value</strong></td>
<td>7,303,997</td>
<td>8,292,652</td>
<td>14%</td>
</tr>
</tbody>
</table>
Portfolio Optimisation: sources of value

- Reduce Cost
- Reduce Risks
- Increase Attractiveness
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The assessment results

- Consolidated view of a portfolio
  - Flexible Excel model
  - Colour-coded cells
  - Drill-down to more detail on each Topic
  - Property summaries for each property

<table>
<thead>
<tr>
<th>Portfolio Valuation</th>
<th>Total Value</th>
<th>Assessment</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>Opportunity</td>
<td>Investment</td>
</tr>
<tr>
<td></td>
<td>IRR &gt; 50% on 12% discount rate, 5 years</td>
<td>IRR &gt; 50% on 12% discount rate, 5 years; or mandatory</td>
</tr>
<tr>
<td>Name</td>
<td>Cost Red</td>
<td>Valuation</td>
</tr>
<tr>
<td>Apollo 12321 London Office Occupied</td>
<td>150</td>
<td>5,000</td>
</tr>
<tr>
<td>Mars 2392 London Mixed Occupied</td>
<td>105</td>
<td>2,500</td>
</tr>
<tr>
<td>Mercury 2135 London Office Occupied</td>
<td>207</td>
<td>2,387</td>
</tr>
<tr>
<td>Baker St 3125 London Mixed Vacant</td>
<td>-45</td>
<td>1,800</td>
</tr>
<tr>
<td>Jupiter 3421 London Office Occupied</td>
<td>82</td>
<td>1,398</td>
</tr>
<tr>
<td>ViaVesuvio 12421 Milan Office Occupied</td>
<td>250</td>
<td>1,296</td>
</tr>
<tr>
<td>Gan Corts 23412 Barcelona Retail Occupied</td>
<td>109</td>
<td>1,250</td>
</tr>
</tbody>
</table>

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KEY QUESTIONS FOR INVESTORS

Have I properly accounted for these new valuation impacts?

Have I reviewed my Portfolio with a view to enhancing value?

Am I delivering the “Sustainability Dividend” for my shareholders?
Thank-you

• For more information / questions

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