Premium Content Exclusively for PrivcapRE Subscribers

PRIVCAPRE REPORTS/

In-depth Analysis From PrivcapRE.com
Q4 2014

SUSTAINABILITY

The economics of green property

With Experts From:

APG Asset Management

Hines

Jonathan Rose Companies

Lend Lease

Proving the Economics of Sustainability

The commercial real estate industry has acknowledged that it's good to be green. But quantifying just how good it is for a landlord's bottom line remains tricky.

How do you gauge the financial impact of installing double-glazed glass, LED lights, and faucet aerators across your real estate portfolio? Or the impact of a recycling program and a drip irrigation system on your occupancy rate? The effect of variable-speed motors on your heating, ventilation, and air-conditioning units on tenant retention?

In this report you'll find an expert panel from two leading sustainable real estate investment managers, Hines and Jonathan Rose Companies, admit that even in 2014 the evidence regarding the economics of sustainability is largely anecdotal. And that's a problem.

During the past five years, the industry has taken great strides in measuring sustainability and building performance, thanks to organizations such as the ULI-Greenprint Center for Building Performance and GRESB (the Global Real Estate Sustainability Benchmark), which conduct annual surveys measuring property and portfolio energy consumption, water usage, waste, and emissions.

The data from ULI-Greenprint and GRESB is powerful, providing investors with the tools to benchmark their managers and underlying portfolios. However, while these tools can tell managers how the introduction of a feature like infrared mixing valves on faucets will reduce water consumption by 3 percent a year, it can't tell them whether it will lift rental rates or reduce vacancy.

Without hard data, it will be difficult to convince more value-added and opportunistic fund managers, who have much shorter investment periods and thus payback time frames, of the merits of making the necessary cap-ex to undertake relatively unseen and unsexy sustainable measures, rather than enacting more visible measures like lobby renovations.

However, things are changing. The data is becoming richer and more sophisticated each year, and it's only a matter of time before the correlation can be quantified. As James Stawniczy of Lend Lease says in this special report, most new green buildings require a 10-to-15-year time frame to fully judge returns, and with developers' and investors' commitment to sustainable projects really escalating post-2005, 2015 could mark the start of a flow of data that proves the economics of investing sustainably.

Enjoy the report,

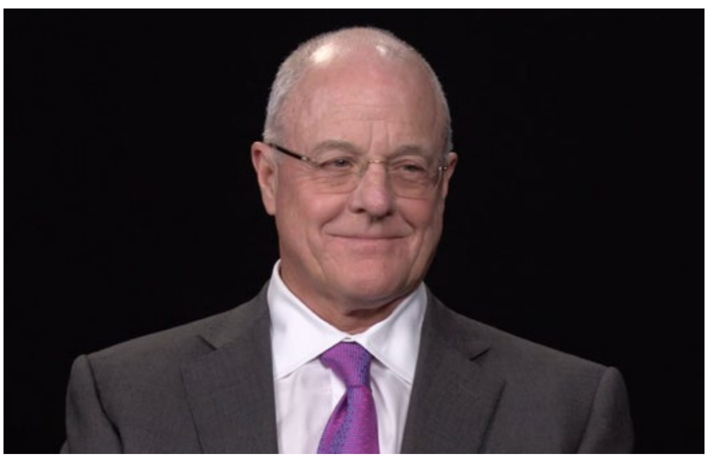
Zoe Hughes
Editor
PrivcapRE
@Hughes_Views

In This Report

Click to watch this video at privcapre.com

The One-Year Payback

The average payback time for sustainability features in real estate portfolios is just 1.2 years, yet managers are running the risk of asset obsolescence by failing to invest in them. **Ken Hubbard** of **Hines** and **Wendy Rowden** of **Jonathan Rose Companies,** who joined PrivcapRE for a panel discussion on the economics of sustainability, argue that the impact on NOI growth and tenant retention is clear, even if the data is not.



Ken Hubbard
Senior Managing Director
Hines

Bio

Formerly CEO of Hines' East Region, **Hubbard** works on special regional projects. He joined Hines in 1974 and was an original member of the firm's executive committee. He formerly led a division to develop bank headquarters around the U.S., and from 1979 to 1984 co-led the firm's East-West division. In 1980 he started the Hines East Region. He holds degrees from Duke University and Georgetown Law School.

Wendy Rowden
Managing Director,
Jonathan Rose Companies

Bio

Rowden was appointed head of the Jonathan Rose Companies' investment practice, Rose Investments, in 2009. She is a member of the firm's investment and management committees and is responsible for the company's focus on green real estate investment and development. Rowden was previously general counsel and secretary of The Rockefeller Group and a member of the board of directors and executive committee of Cushman & Wakefield. She holds degrees from Brown University, the University of Michigan, and New York University.

CONTINUES ON NEXT PAGE

Few in the commercial real estate sector would argue against the need to embrace sustainability. However, the data to support the argument for investing in "green" initiatives remains less than convincing.

"The correlation is very direct," says Ken Hubbard, senior managing director of Hines. "How you prove it is really the challenge?"

Data proving the relationship between sustainability initiatives and building performance is far more thorough. It was produced through annual surveys by the ULI-Greenprint Council for Building Performance and by GRESB, the Global Real Estate Sustainability Benchmark, which monitor almost 60,000 real estate assets (and their corresponding portfolios) globally, measuring water usage, electricity consumption, emissions, and waste—even tenant satisfaction and community involvement.

Hubbard says that this performance measurement will eventually lead to a cohesive argument for the economics of sustainability. While there is no direct data correlation between the introduction of one sustainability measure and an improvement in tenant retention, absorption rates, or rental rates, he feels that measuring a building's performance on energy usage, waste, and emissions—and communicating that measurement to tenants—will be critical to ultimately proving the economics of sustainability.

"We measure energy efficiency, we measure water, we measure waste," Hubbard says. "There is a whole host of things that we will be measuring in our buildings. The accumulation of facts is becoming better and better and better, and software is becoming more sophisticated, so that you can actually see what you're measuring."

"You're asking for a value equation," Hubbard says. "The energy companies are very involved. Once they've moved into your building and they've picked your building, they are very actively involved with you. They want to know what the measurement systems are, what the results are, the air quality, water consumption, energy consumption. They become your partner, and as time goes on, guess what, they're not going to move out of that building. They might be the tenant, but they own the building, and hopefully you're responsive to what their needs are."

Wendy Rowden, managing director of Jonathan Rose Companies, says being sustainable is about being a hands-on asset manager.

"For us, green is a part of our DNA; we view it as best practices," Rowden says. "We really focus on what I call 'practical greening,' so it's capital expenditures that have a relatively short investment payback and that reduce or control operating expenses. So clearly [those measures] improve net operating income and although we don't yet see higher rents for having greened a building, we do see higher occupancy compared to our peers."

CONTINUES ON NEXT PAGE

"Your building is going to be obsolete if you're not making longer-term investments in it, and there are a lot of things you can do that have a payback of three to five years that ought to be considered. But if you look at the industry average, it's still 1.2 years."

–Ken Hubbard, Hines

"The failure to make these hands-on investments will result in the building trading at a discount down the road. It's an important risk mitigator and, we think, ultimately a value enhancer."

–Wendy Rowden, Jonathan Rose Companies

What's Next for Sustainability? Healthy Buildings

Rowden: The next big step is to focus on health and healthy buildings and the built environment. There is increasing demand and focus on making sure that the air quality is good, making sure that you have access to green space, gardens, exercise, bike rooms, showers, fitness rooms.

Hubbard: We're taking a lot of steps. For example, Seven Bryant Park, in New York. We have 10-foot-wide mullions, full glass. We have 10-foot-high ceilings, so you get a lot of the column-free space; you get terrific natural light. We have green gardens. We're going to have great sports amenities within the building. But I have a little bit of caution. We have to be careful what our claims are, and we have to find things that are clearly measurable. That's why sustainability had such great success—because most firms concentrated on "What can we actually prove? What can we actually measure?" As we enter this new zone of healthy buildings, we've got to protect our credibility, and let's pick those things that we can act on, that we can measure.

Wendy Rowden, Jonathan Rose Companies; Ken Hubbard, Hines

Hubbard agrees that sustainability in 2014 is more about using best practices, rather than providing the competitive advantage it offered when "green" first entered the real estate lexicon. "When the sustainability initiative began, it was somewhat novel," he says. "And then it moved into the next zone, where it became more of a best practice."

Rowden says landlords needed to not only introduce sustainability initiatives; they needed to communicate them to tenants. Failure to do so is akin to throwing capex down the drain. "It's important for the tenants, the residents in our apartment buildings, and for the tenants in our office buildings to be part of that conversation. Otherwise you're wasting money," she says.

Jonathan Rose has introduced competitions in certain assets, Rowden says. These initiatives give tenants challenges to encourage more sustainable behavior. One such scheme is at a master-metered, affordable housing project for seniors in Newark, N.J., where Jonathan Rose received a grant by the U.S. Department of Housing and Urban Development to install wireless meter controls in tenant units. The challenge for the landlord was educating "nice grandmothers" about adjusting their air conditioning rather than opening the window to let in cold air.

"The floor that shows the most [energy consumption] improvement gets an all-expenses-paid bus trip to Atlantic City. No gambling money, but they love it," she says. "I used to say, if you can train your grandmother to change her behavior, you can get anybody to do it. The reality is that otherwise we all revert back to what's easiest."

Rowden and Hubbard agree that, given the relatively short average payback time on sustainability features, managers and owners are foolish not to make the investment.

Hubbard says the average payback time for an energy-efficient retrofit is 1.2 years, "which means it's coming out of an operating expense."

"Your building is going to be obsolete if you're not making longer-term investments in it, and there are a lot of things you can do that have a payback of three to five years that ought to be considered. But if you look at the industry average, it's still 1.2 years," he says.

Rowden says her firm typically looks at "an investment payback of under five years." She adds that disclosure by municipalities on building energy performance would increasingly drive tenant leasing decisions.

"The failure to make these hands-on investments will result in the building trading at a discount down the road. It's an important risk mitigator and, we think, ultimately a value enhancer." ■

Click to watch this video at privcapre.com

Sustainability, Lend Lease Style

Global property and infrastructure group **Lend Lease** is renowned for its focus on sustainability; the $4.8B company aspires to be a leader in the field. The firm's **James Stawniczy** tells PrivcapRE about the group's sustainability initiatives and how they have been incorporated into two major projects.

James Stawniczy, Lend Lease

Bio

James Stawniczy, Vice President and Head of Sustainability - Americas, joined Lend Lease in 2007 and is responsible for leading the company's sustainable building efforts in the region. He is a member of the American Institute of Architects and is LEED-accredited. Stawniczy received a degree in architecture from the Pratt Institute.

PrivcapRE: Lend Lease puts a big emphasis on sustainability. How do you define sustainability?

Stawniczy: Traditionally it's always been social, economic, as well as environmental sustainability as three separate milestones. We've moved away from that and realized that that has to happen without any sort of title. We're moving to more of a platform where we say sustainability is all about people. It's the people who live in our units, it's the people who we work near when we build a project, and it's about our own people. So making sure that we're doing the right thing not only sustainably but from a health and well-being perspective as well.

Is there any evidence that investing in sustainability is delivering better returns for both the company shareholders and the investors in your funds?

Stawniczy: Investors will invest in whatever building is going to make a profit, and you don't really see LEED

CONTINUES ON NEXT PAGE

Rooftop solar panels at a Lend Lease-owned community in Hawaii

[Leadership in Energy and Environmental Design] or green building classifications affecting their decision. Some [investors] demand it as a requirement of the funding. Those are just companies with a larger, greener mission. In some cities, such as Boston,...[governments] require that you follow green building standards. So [investors] won't fund you unless you pursue those classifications for the building.

You need a 10-to-15-year time frame [to judge the returns on green buildings], and the escalation of sustainable projects really didn't get moving until 2005. Given another 10-year time frame, we'll actually see that those efforts will pay off in the long term for a project. And investors will start to see that.

Can you talk about the sustainability work that Lend Lease is doing with military housing?

Stawniczy: We're wrapping up a program we started in 1999. For 15 years we've owned, operated, and leased 42,500 military homes throughout the country. So we have a large energy bill, because we pay the energy for these units. We struggled with trying to reduce energy costs.

What we've done is gone into smart metering, and remote-controlled systems that can lower the air-conditioning or raise the temperature and lower the shades. And [we have] also developed new forms of energy. We have two of the largest solar power communities for the Department of Defense, in Arizona and in Hawaii. That deals with the consumption perspective. We produced about 40 percent offset on both of those installations, but the supply cost was the same. We've created competitive programs within those communities, such as one that rewards tenants and users for recycling more waste or using less electricity. And the benefit of that is, we can take that money and reinvest it within the community.

Is there a commercial project that demonstrates Lend Lease's sustainability ethos?

Stawniczy: We're building a project in Sydney, Australia, on military land that we were awarded through a competitive program with the New South Wales government. And that project is a series of towers and parklands integrated into the existing city grid. The buildings themselves are being designed to be net [energy] positive, or net zero at a minimum, to actually give back to the community. ■

Click to watch this video at privcapre.com

Sustainability Is Non-Negotiable

As one of the founders of the Global Real Estate Sustainability Benchmark (GRESB), Dutch pension group **APG Asset Management** is serious about sustainability, says **Patrick Kanters,** the firm's managing director of real estate and infrastructure.

Patrick Kanters, APG Asset Management

Bio

Amsterdam-based Kanters joined APG Asset Management in 2005. Prior to joining APG, he spent 11 years with ING Real Estate. Kanters is responsible for the company's real estate and infrastructure holdings, which comprise publicly listed real estate and infrastructure securities, select private entities, funds, and co-investments. He serves on the board of Steen & Strom, a Scandinavian shopping center investor, operator, and developer, and is a member of the executive board of the European Public Real Estate Association. He has degrees from Delft University of Technology and the University of Amsterdam.

CONTINUES ON NEXT PAGE

"There are still a lot of parties who are not doing well on the sustainability front, and in further educating them, we can make quick improvements."

–Patrick Kanters, APG

PrivcapRE: APG is at the forefront of many sustainability initiatives globally. How do you monitor and benchmark your managers in terms of their sustainability efforts and their portfolios?

Kanters: As you probably know, we were one of the launching partners of the GRESB benchmark. Before that, you could not measure the sustainability of companies and funds. Now we can truly measure the state of sustainability and compare and contrast within certain sectors, within regions, and across regions. So it does provide us with, the information to start that engagement with our partners, to see where they can improve, and to learn from that. The information also provides further evidence that being more sustainable actually adds [to your] returns or at least lowers your risk [profile].

Do you see a correlation between environmental performance and financial performance?

Kanters: It is still difficult, but there is more and more evidence getting to the table right now because of [surveys like] GRESB. GRESB has been out there for five years now, and other information is also being analyzed, so making that case is becoming far more easy—although most parties are way beyond the point that they somehow question whether sustainability will actually increase your returns or lower your risk going forward.

Do you feel that the CEOs and CIOs have bought into the importance of sustainability within their own portfolios?

Kanters: It's taken extremely seriously. If you look at the outcomes of GRESB—where there's still an increasing amount of so-called "Green Stars," which are the upper-quartile performers—if you look at the CO_2 emissions, if you look at water usage, it's all improving. It's not enough. It should improve even more.

Look at our portfolio, for example. Every year there are more Green Stars in our portfolio. It's also partly due to our engagement and that we simply insist on filling in the survey. We [GPs} play quite hard. If we want to invest in your fund, you have to fill in the survey. If you don't fill in the survey, we will not invest in your fund. If the outcome, however, is not overly positive, it doesn't immediately say that we will not invest. But we want to have a clear commitment [for you] to improve yourself.

And what are your ambitions? What do you want to see over the next few years?

Kanters: There are still a lot of parties who are not doing well on the sustainability front, and in further educating them, we can make quick improvements. That's very important to us. But equally important is the need to have a good governance structure and good operating partners.

The criticism I've heard about investors is this becomes a checklist item. Is this fundamental to the DNA of APG?

Kanters: Absolutely. It's fully integrated in our investment policy, and just like tax and legal need to sign off internally before we make an investment, our sustainability department also has to sign off [on an investment] based on the outcomes of the GRESB survey. ■

From the Archives

MULTIFAMILY & RESIDENTIAL

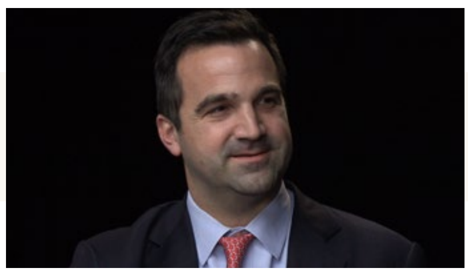
Carroll Organization's Multifamily Growth

Carroll Organization's Pat Carroll discusses growth plans for the multifamily investment firm, fundraising as an emerging manager, and the possibility of M&A.

Institutionalizing Single-Family Homes

The opportunity to institutionalize the ownership of single-family homes is huge, says Starwood Waypoint's Colin Wiel, given the large percentage of properties still held by "mom and pop" investors.

HOSPITALITY



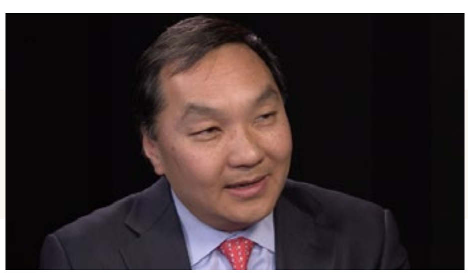
Targeting Hotel Distress Six Years Post-Crisis

Jim Merkel of Rockbridge discusses the U.S. hospitality market, room rate growth, and the firm's play in hospitality debt and equity. Distressed opportunities are available as brands push owners for increased cap-ex.

A Hospitality Comeback

The hospitality business—particularly limited-service hotels—has bounced back from recent lows, says Tyler Morse of MCR Development.

DEBT



CRE Debt in Equilibrium, World Eyes U.S. Opportunity

Drew Fung of Clarion Partners tells PrivcapRE why U.S. real estate is on the world's radar, analyzes how the rate roller coaster will look in 12 months, and explains demand for floating-rate mezzanine loans.

Gauging Appetite: Commercial RE Debt

A discussion with David Rose of Hewitt EnnisKnupp about the role of commercial RE debt in the institutional portfolio.